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NATIONAL PLANNING, ITS' PRINCIPLES & ADMINISTRATION — *K. T. Shah.*

NATIONAL PLANNING COMMITTEE SERIES

(Report of the Sub-Committee)

CURRENCY AND BANKING

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Shri MANU SUBEDAR

Secretary

Prof. C. N. VAKIL

Edited by

K. T. SHAH

Honorary General Secretary

NATIONAL PLANNING COMMITTEE

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To

All Those

MEMBERS OF THE NATIONAL PLANNING COMMITTEE

and of

Its Various Sub-Committees

A TRIBUTE OF APPRECIATION

प्रारब्धमुत्तमजना न परित्यजन्ति

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PREFACE

The National Planning Committee, appointed in 1938, began its work early in 1939. After defining the nature of a National Plan, and determining the nature and scope of the work entrusted to them, the Committee issued an elaborate and comprehensive Questionnaire which was subsequently supplemented by specific details. Twenty-nine Sub-Committees, formed into eight groups, were set up with special terms of reference to deal with all parts and aspects of the national life and work in accordance with a predetermined Plan.

After some unavoidable delay in getting replies to the Questionnaire, the Sub-Committees began their work, and submitted Reports,—some of them Final, some Interim,—which were considered at the Plenary Sessions of the Parent Committee in 1940. Towards the end of that year the Chairman, Pandit Jawaharlal Nehru, was arrested and sentenced to a long term of imprisonment, during which the work of the Committee had necessarily to be suspended.

On his release a year later, hope revived for an intensive resumption of the Committee's work. But the outbreak of war with Japan, the threat to India's own safety, and the hectic march of political events, rendered it impossible to devote any attention to such work at that time. It, therefore, inevitably went into cold storage once again; and remained for the duration of the war.

When at last the War seemed nearing its end, Pandit Jawaharlal Nehru with other leaders was released. The moment seemed again opportune to resume the work of

the Planning Committee. Meetings of that Body were held in September and November 1945, when certain more urgent questions, already included in the programme of the National Planning Committee, were given a special precedence. A Priority Committee was appointed to report upon them. Changes and developments occurring during the War had also to be taken into account; and another Committee was appointed to review the general instructions, given six years earlier to the Sub-Committees. Revised instructions were issued to them following the Report of this Sub-Committee; and the Chairmen and Secretaries of the several Sub-Committees were once again requested to revise and bring up to date such of the Reports as had already been submitted—either as final or interim—while those that had not submitted any reports at all were asked to do so at an early date.

As a result, many of the Sub-Committees which had not reported, or had made only an Interim Report, put in their Reports, or finalised them. The Parent Committee has had no chance to review them, and pass resolutions on the same. But the documents are, by themselves, of sufficient value, prepared as they are by experts in each case, to be included in this Series.

The following Table shows the condition of the Sub-Committees' work, and the stage to which the Planning Committee had reached in connection with them.

Serial No.	Name of the Sub-Committee.	Final Report: N.P.C. Resolutions	Final Report: Not considered by N.P.C.	Interim Report: N. P. C. Resolution	Interim Report: Not considered by the N.P.C.	No Reports
Group I.	**Agriculture & other Sources of Primary Production**	Handbook Pp.		Handbook Pp.		
1.	Rural Marketing and Finance	97-99				
2.	River Training and Irrigation Part I	83-85				
	,, ,, ,, Part II	113-115				
3.	Soil Conservation and Afforestation	115-119				
4.	Land Policy and Agriculture			139-141		
5.	Animal Husbandry and Dairying	87-89				
6.	Crop Planning and Production				do.	do.
7.	Horticulture	102-103				
8.	Fisheries		do.			
Group II	**Industries or Secondary Sources of Production**					
1.	Rural and Cottage Industries					
2.	Power and Fuel		do.			
3.	Chemicals					do.
4.	Mining and Metallurgy			77-79		
5.	Engineering Industries	75-77		130-133		
6.	Manufacturing Industries		do.			
7.	Industries connected with Scientific Instruments		do.			
Group III	**Human Factor**					
1.	Labour	89-92				
2.	Population	85-87				
Group IV	**Exchange and Finance**					
1.	Trade					
2.	Public Finance			130		do
3.	Currency and Banking			122-126		
4.	Insurance			93-95		
Group V	**Public Utilities**					
1.	Transport			95-97		
2.	Communications	126-129		120-122		
Group VI	**Social Services—Health and Housing**					
1.	National Housing	99-100				do.
2.	National Health			152-154		
Group VII	**Education**					
1.	General Education			138-139		
2.	Technical Education				do.	
Group VIII	**Woman's Role in Planned Economy**	154-160				

To sum up, fourteen Sub-Committees had made final reports, of which ten have been considered, and Resolutions taken upon them, by the National Planning Committee. Twelve more have presented Interim Reports, of which nine have been considered by the Planning Committee, with Resolutions thereon, while three Sub-Committees have not yet presented any report on the reference made to them.

The idea that all this material, gathered together with the help of some of the best brains in India in the several departments of our national life, should be printed and published was before the Committee from the start. But the interruption caused by the war prevented its realisation. It was once again mooted in 1941; but the moment was not deemed ripe then for such action, partly because the leading spirits in almost every one of the Sub-Committees were unable to devote time and labour to bring their Reports up-to-date; and partly also because war-time restrictions or shortages had made scarcer than ever before the statistics and other facts, which particular sub-committees would need, to bring their work up-to-date. The war-time needs of Government had attracted several of them to work on Government Bodies, Panels, or Committees. For all these reasons it was deemed undesirable that material of this character—valuable as it must be—should be put out in an incomplete, inchoate, obsolete form, which may reflect unfavourably upon Indian capacity for such tasks.

The last four years of the War were thus a period of suspended animation for the National Planning Committee. Even after the end of the war, it has not been feasible, for obvious reasons, for the Planning Committee to resume its work and finalise decisions. Continuous sessions of that body are indispensable for considering and taking decisions on the Sub-Committee reports presented since 1940, and putting all the material into shape, ready for publication, not to mention making its own Report; but the political situation in the country made it impossible. Other conditions, however, are somewhat more favourable than in 1938-39, when the Central Government of the country were all but openly hostile to such attempts. Lest, however, the momentary difficulties make for needless further delay, it was thought advisable by the Chairman and the undersigned that no more time should be lost in putting this material before the Public. Following this advice, it is now proposed to bring out a complete Series of the National Planning Committee's Sub-Committee Reports, which will

serve as appendices to the Parent Committee's own Report. The Plan of the proposed enterprise is briefly summarised below.

Every Sub-Committee's Report, which is in a final form and on which the National Planning Committee has itself taken resolutions, will be edited and published, with an Introduction assigning their due importance to the suggestions and recommendations contained in that particular report, its proper place in the over-all National Plan; and following it up, wherever necessary, by a kind of Epilogue, summarising the developments that have taken place during the seven years, during which the work of the Planning Committee had been in suspension.

Those Reports, again, which, though in a final form, have not yet been considered, and no resolutions taken thereon, by the Planning Committee, will also be included in the Series in the form in which they were submitted, with such Introduction and Epilogue to each as may be deemed appropriate. And the same treatment will be applied to Reports which are 'Ad Interim', whether or not the Parent Committee has expressed any opinion on the same. They will be finalised, wherever possible, in the office, with such aid as the Chairman or Secretary of the Sub-Committee may be good enough to render. Sub-Committees finally, which have not submitted any Report at all, —they are very few,—will also find their work similarly dealt with. The essence, in fine, of the scheme is that no avoidable delay will now be suffered to keep the National Planning Committee's work from the public.

Both the Introduction and the Epilogue will be supplied by the undersigned, who would naturally be grateful for such help as he may receive from the personnel of each Sub-Committee concerned. The purpose of these additions is, as already stated, to assign its true place to each such work in the over-all Plan; and to bring up the material in each Report to date, wherever possible.

Not every Sub-Committee's Report is sufficiently large to make, more or less, a volume by itself, of uniform size, for this Series. In such cases two or more Reports will be combined, so as to maintain uniformity of size, get-up, and presentation of the material. The various Reports, it may be added, would not be taken in the order of the classification or grouping originally given by the Planning Commit-

tee; nor even of what may be called the intrinsic importance of each subject.

In view of the varying stages at which the several Reports are, for reasons of convenience, it has been thought advisable to take up for printing first those which are final, and on which the Planning Committee has pronounced some resolutions. Printing arrangements have been made with more than one Press, so that two or three Reports may be taken simultaneously and published as soon as possible so that the entire Series may be completed in the course of the year.

Two other Sub-Committees, not included in the list of Sub-Committees given above, were assigned special tasks of (1) preparing the basic ideas of National Planning; and (2) outlining the administrative machinery deemed appropriate for carrying out the Plan. These were unable to function for reasons already explained. The present writer has, however, in his personal capacity, and entirely on his own responsibility, published the "Principles of Planning" which attempt to outline the fundamental aims and ideals of a National Plan. This remains to be considered by the Planning Committee. Similarly, he has also attempted to sketch an administrative machinery and arrangements necessary to give effect to the Plan, when at last it is formulated, and put into execution. Notwithstanding that these two are outside the Scheme outlined in this Preface, they are mentioned to round up the general picture of the arrangements made for publication of the entire work up-to-date of the National Planning Committee and its several Sub-Committees.

The several volumes of Sub-Committee Reports, when published, will be treated as so many appendices to the Report of the parent body, the National Planning Committee. It is impossible to say when that Committee, as a whole, will be able to hold continuous sessions, review and resolve upon Sub-Committee Reports which have not yet been considered, and lay down their basic ideas and governing principles for an all over Plan, applicable to the country, including all the facts of its life, and all items making up the welfare of its people.

The disturbed conditions all over the country, and the Labour unrest that has followed the end of the War has caused unavoidable delays in printing and publishing the

several volumes in the Series, which, it is hoped, will be excused.

In the end, a word of acknowledgment is necessary to put on record the aid received by the Editor in the preparation and publication of this Series. All those who are associated in the task,—members of the Parent Committee, or as Chairmen, Secretaries or Members of the various Sub-Committees,—have laboured wholly, honorarily, and consistently striven to give the best that lay in them for the service of the country. Almost all Provincial Governments and some States,—the latter twice in some cases,—have made contributions towards the expenses of this office, which have been acknowledged and accounted for in the Handbooks of the Planning Committee, published earlier. Suitable appreciation of these will be expressed when the Parent Committee makes its own Report. At almost the end of its task, the expenditure needed to edit, compile, and otherwise prepare for the Press, the several Reports, has been financed by a Loan by Messrs. Tata Sons Ltd., which, even when repaid, will not diminish the value of the timely aid, nor the sense of gratitude felt by the undersigned.

Bombay, 1st July 1947. K. T. Shah.

Note:—In the Scheme of this Series, originally given, more than one Report was intended to be included in one volume in some cases. The combinations indicated in the circular, of the 20th of June 1947, had had to be modified as the printing of several Reports proceeded.

When about half the volumes were printed, it was found that that scheme would not give a fairly uniform series. The new arrangement is given on the page facing the title page. Some changes have had to be made in that list e.g., the separation of the two Reports on Public Health and National Housing, intended to be in one volume, are now in separate volumes.

Conversely, only the two Reports on Animal Husbandry and Dairying and on Fisheries were intended to be combined. As now decided, the Report on Horticulture is also included in the same Volume.

Again, the original combination of the Report on Mining and Metallurgy with that on Engineering Industries has been modified. The latter now combined with the Report on Industries Connected with Scientific Instruments, which was originally meant to be a separate volume, while the former is to be by itself.

31st January, 1948. **K. T. S.**

CONTENTS

INTRODUCTION

I. Terms of Reference

This Sub-Committee was appointed to deal with:—

(a) banking and currency, including all forms of legal-tender money as well as deposit currency,

(b) the credit system of the country in general,

(c) regulation and control of foreign exchanges,

(d) regulation and control of the country's metallic reserves and other valuta for the service of foreign exchange,

(e) the various types of banking including central banks, industrial banks and commercial banks, co-operative banks, land-mortgage banks, postal banking etc.,

(f) ways and means of mobilising capital within the country and conserving the same for effective employment in the service of the country's agriculture and industry,

(g) saving and investment habits and

(h) measures for linking up rural credit with the capital market.

II. Plan of the Sub-Committee's Report

In amplification of the scope of work of the Sub-Committee on Currency and Banking the following heads of enquiry were laid down by the Sub-Committee, and the work of preparing the memoranda on the several items was distributed among the members named below.

(a)

1. Forms of Currency and Legal tender Money	Mr. M. Frydman
2. Standard of Value	" "
3. Regulation and Control of Foreign Exchanges	Prof. K. T. Shah
4. Relation of Money and Credit	" "
5. Prices	" "

(b)

6.	Reserve Bank ond Regulation of Banks in India	Mr. M. L. Tannan
7.	Joint Stock Banks	" "
8.	Exchange Banks	" "
9.	Saving and Investment	Prof. K. T. Shah
10.	Savings Banks	" "
11.	Stock Exchange	Prof. C. N. Vakil
12.	Government Borrowing	Mr. M. Subedar
13.	Investment Trusts	" "
14.	Land Mortgage Banks	Prof. C.N. Vakil
15.	Postal Banking	Prof. K. T. Shah
16.	Mobilisation of Capital	Mr. M. Subedar
17.	Linking agriculture and other rural activities with the capital market	Mr. M. Frydman
18.	Conclusion	
19.	Summary	

The work of the Sub-Committee was presented in an Interim Report on which the National Planning Committee took certain resolutions which are given in the text that follows.

In conformity with the general plan of Introduction to these Reports, it is proposed, however, to consider in this introduction the various subjects included in the Terms of Reference from the standpoint of money, currency, legal tender, and banking with reference to their due place in a comprehensive planned National Economy so as to aid the progressive working out of the Plan with the utmost efficiency.

In order, however, to appreciate the several problems of our Currency System today and their solutions in conformity with an all round National Plan, it is necessary to give a brief sketch of the historical development of the Currency System in its several aspects.

III. Evolution of the Present Indian Currency System

The existing currency system of India is the creation, almost entirely, of the British regime in this country. Upto the beginning of the governance of India directly under the British Crown, the Indian monetary system was based on the Silver standard, uniformity of value having been attained by the labours and ordinances of Akbar. With the decline and fall of the Mughal Empire, that unity was lost, and a number of mints as well as standards, sprung up in the country, which made even internal exchange a matter of no mean complexity.

Generally speaking, however, both for internal as well as foreign commerce, the silver Rupee remained the standard, though its weight and fineness varied from State to State, and even within the same State from ruler to ruler. Debasement of currency for the purpose of enriching the ruler was not infrequent; but its virulence was easily discounted by the common practice of large commercial transactions being settled by weight and fineness of the bullion used.

This practice, with all its advantages and disadvantages, was adopted by the East India Company, almost throughout its career in India. As, however, more and more parts of the country came under the dominion of the Company, a uniform coinage—the Company's Rupee,—came to be established; and when paper money was legally authorised to be issued, it was expressed in terms of that standard. The mints of feudatories or allies were either suppressed, or agreed to be closed, the paramount power agreeing to supply all the coinage and currency needs of such States.

A new chapter begins with the discoveries of new sources of gold and silver,—the basis for the currency systems of all civilised countries upto the end of the XIX Century. Unexpected jolts were suffered by the slowly standardising Indian monetary system. The close connection which the East India Company, and, after its abolition, the Government of India had maintained with the British monetary system,—through the former's "Investment" and the latter's "Home Charges",—necessitated a constant attention to the Rupee-Sterling rate of exchange, which eventually proved fatal to the stability of the rupee, and the independence of the Indian currency system.

In the latter half of the last century, more and more European countries began to remodel their currency systems. They were based on gold which was assumed to be an unfailing index of national prosperity. The British currency system had been based on gold as early as 1819 if not a century earlier when Sir Issac Newton was master of the Royal Mint. The continued prosperity of that country, with the lead it had in modern industry and its consequent domination in world commerce, made limitation of the British model irresistible. New gold mines discovered in Australia, Africa, and America added to the quantity of gold in use both for purposes of art and of currency. But this increased quantity was more than absorbed because of the growing volume of international commerce, and the consequent demand for gold in settling the final balance of accounts between nations.

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Discoveries of silver on the other hand, which also happened about the middle of the last century, added to the quantities of that metal in circulation, and so contributed to a gradual decline in the gold value of that metal. This was accentuated because of the simultaneous demonetisation of silver over a steadily increasing area in the world of commerce; and the process was completed by the discovery of a new process for producing silver as a by-product from other articles of world trade. The cost of production of that article was more than ever reduced, and the metal became progressively less valuable.

These world factors reacted upon the Indian monetary system under British rule in a steady depression of silver in terms of gold. The Rupee began to lose in value in relation to gold. Thanks to the unceasing demand for gold,—or the pound sterling, which was synonymous for gold throughout the century ending with the World War I,—to pay the "Home Charges" of the Government of India, the exchange value of the rupee sagged progressively. From about 30d to the rupee at the beginning of the last century, it fell to 24d per rupee by the time the East India Company was liquidated, and the Governance of India was transferred to the British Crown direct. Thereafter the process was even more rapid. In the seventies and eighties, the Indian Budget was incessantly thrown out of balance by the falling gold value of the rupee. As the revenues of the Indian Government were collected in rupee, and as a considerable part of its expenditure was in sterling, the problem of conversion always meant a heavy loss, which eventually drove the Government of India frantic. Advice was sought from the one source then thought to be alone competent to advise, however interested, however tainted, it might be. The demands of the rising Indian industry and foreign trade were overlooked. Indian mints were closed to the free coinage of silver rupees in 1893. The rupee thus became scarce, and acquired an artificial value in terms of the pound sterling. The advantage to India's export trade, inherent in the falling exchange value of her standard coin was unappreciated, or deliberately ignored; and our currency system was tied irrevocably for the rest of the duration of the British rule in India, to the vagaries or vicissitudes of the pound sterling.

Under legislation passed in 1899, following the Fowler Committee Report, Government bound themselves to give, at a fixed ratio of 1 rupee=to 16d, any number of pounds for rupees, and vice versa, allowing a margin on either side of a small fraction of a penny considered equal to the cost of im-

port or export of gold into or from India. The coinage of rupees, which was stopped in 1893, was resumed, not as an unrestricted public service at fixed rates, but as a Government monopoly, which yielded a most substantial seigniorage. Thanks to its scarcity, and the growing demand due to the increasing foreign commerce of India, the rupee maintained its artificially enhanced value in exchange. The growing profit of its coinage, was at first kept apart in gold in a special fund called the Gold Reserve Fund, later on amalgamated with the so called Gold Standard Reserve. The gold, however, in this Fund soon disappeared, as it was considered uneconomic to keep locked up such large amounts in idle bullion. The Fund was, consequently, invested in British securities, which made the first beginnings of what we now call **Sterling Balances.** After a first faint attempt, no gold currency was minted in India; and no working Gold Standard established, as recommended by the Fowler Committee. But for these essential omissions, the recommendations of the Fowler Committee were adopted and more or less given effect to as and when it suited Government.

The subsequent fortunes of this Fund, and its counterpart in the Paper Currency Reserve, are unnecessary to detail here, beyond observing that they scarcely ever fulfilled the declared purpose of their original institution. At the first touch of a crisis, for instance, in 1907, Government disowned their obligation to give gold for silver rupees and vice versa. The years of World War I confirmed the worst apprehensions of the Indian critics of this managed currency system, christened specifically into Gold Exchange Standard by the fertile imagination and facile pen of the late Lord Keynes.

World War I saw the beginnings, also, of what is now called Inflation. It came about for the same reasons, showed the same symptoms, and called out the same nostrums from the same type of quacks called in to treat the malady. The Note Issue was inflated to three times the maximum circulation before the War, mainly because of the Indian Government's commitments on account of the British during the War. An unprecedented,—perhaps illegal gift of a £100 million, later raised to £ 130 million—did not suffice to draw out the new purchasing power from the people's hands, notwithstanding recourse to Treasury Bills and heavy public borrowing at high rates of interest.

Gold had long since disappeared from our currency system, and rupee coinage was no longer profitable. This was not a situation to the advantage of British bankers or brokers, who had reaped a rich harvest from the silver purchases of the

Government of India, and unlimitated sales of the Council Bills to pay the Home Charges. They accordingly recommended, in the guise of the Report of the Babington—Smith Commission, a two-shillings rupee, in the hope that, with that artificial appreciation of the Indian standard(?), British goods would find an easier market in this country, and so aid in the post-war recovery of that country. But after less than a year's disastrous experiment, which wiped off all the accumulated profit of years of silver coinage, and involved a loss of 35 crores to the Indian Exchequer, Government retired from the business confessing their failure and admitting the losses. Perhaps no other chapter in the currency history of India is sadder or costlier.

In the years after 1920, the rupee seemed to have regained its more customary level in exchange, Re. 1=16d. This, however, did not quite suit the British exporter to India, especially in the face of the new fiscal policy, which had accepted the principle of fiscal protection to Indian Industry. A new Commission was, therefore, constituted,—fifth in 30 years, —presided over by Hilton-Young; and on its recommendations the foundations were laid of what may be called the present currency system.

IV. Metallic Currency Since 1927

The Indian Currency Act of 1927 established the new ratio of 18d=1 Re. (gold) and provided that Government would purchase gold at a price of Rs. 21-3-10 per tola of fine gold in bars of not less than 40 tolas each; and would sell gold, or, at their option, sterling, for immediate delivery in London, at the same price, after allowing for the normal cost of transport from Bombay to London. A rate of 1sh. 5-49/64 was notified as Government gold (or rather sterling) selling rate; but within four years of the legislation, Britain herself having gone off gold, the new Act became a dead letter so far as gold sales were concerned.

This was an act of perfidy, which, though not without plenty of precedents in the Currency History of India, was unique of its kind in international dealings, particularly by a country which had prided itself on its being the world's only free gold market; and where, therefore, on the strength of such pretensions, other countries were accustomed to keep handsome balances to settle their own accounts in international trade. With the break with gold in Britain, India had to toe the line. Gold began to be purchased, not at the fixed, but at a steadily mounting rate in India and was exported to

bolster up the tottering pound. The Table appended shows what amounts of gold left India during the Depression Decade commencing with 1930.

It cannot be repeated too often that this was due mainly, if not entirely, to the rupee being tied to the pound sterling, which has never been synonymous with gold in the last generation. Had the rupee been dislinked from the pound, and left free to shape its own course it is possible the initial shock of World Depression would have reduced its value in dollar or gold. But the intrinsic strength of the Indian export market, further stimulated as it must be by a substantial fall in exchange, would have soon asserted itself. And had those who had the management of the Currency System in their hands sought to promote the interests of this country only, and conserved the balance of payment received in international settlement of accounts into substantial reserve, gold, instead of flowing out of the country, would in all probability have flowed in, and so provided a more dependable backing for our currency system during the next crisis which came with World War II. The Table showing imports and exports of Gold, including Sovereigns, and Silver, since the commencement of the century, tell their own tale in corroboration of the argument advanced above. (Table on pp. 24-25.)

V. Paper Money—Note Issue

Hitherto only the metallic portion of the currency system has been considered. Paper money or Currecy Note circulation is however much more important, both in volume and in its reaction upon the aggregate national economy. It is the most easily affected item in the regulation of the price-level, and is the main source of inflationary and deflationary trends. Its place in the present structure in India's national economy must, accordingly be studied with some care. All the theories about money elaborated by classical economists revolve round this most considerable portion of a country's currency system, especially in a country where deposit currency by cheques is not very common.

Paper money began in India in the middle of the last century. Several banks issued Notes, each on its own responsibility. Wiser, however, by the experience of such bank-notes in England, the Note Issue was vested and concentrated in 1861 in the three Presidency Banks of Bombay, Calcutta and Madras. These were private Institutions, no doubt; but in consideration of this great privilege of becoming the only channels for the issue of legal tender Currency Notes, they

TABLE I

Value of Imports and Exports of Gold Coin and Bullion and Silver* (India and Burma) Since 1900-01

(Figures are in Crores of Rupees)

	Total Imports of Gold.	Total Exports of Gold.	Net Imports (+) or Exports (—) of Gold.	Total Imports of Silver.	Total Exports of Silver.	Net Imports (+) or Exports (—) of Silver.	Total Imports of Gold, Bullion and Silver.	Total Exports of Gold, Bullion and Silver.	Total Imports(+) or Exports (—) of Gold, Bullion and Silver.
Average for									
1900-01 to 1904-05	15.0	8.8	+ 6.2	14.6	4.5	+ 10.1	29.6	13.3	+ 16.3
1905-06 to 1909-10	17.4	5.7	+ 11.7	17.7	2.3	+ 15.4	35.1	8.0	+ 27.1
1910-11 to 1914-15	29.9	4.5	+ 24.3	14.1	3.5	+ 10.6	44.0	8.0	+ 34.9
1915-16 to 1919-20	19 6	6.2	+ 13.4	30.7	2.7	+ 27.9	50.3	8.9	+ 41.3
1920-21 to 1924-25	36.4	7.7	+ 28.7	19.1	3.4	+ 15.7	55.5	11.1	+ 44.4
1925-26 to 1929-30	21.6	0.1	+ 21.5	17.4	3.6	+ 13.8	39.0	3.7	+ 35.3
1930-31	13.2	0.4	+ 12.7	13.4	3.3	+ 10.0	26.6	3.7	+ 22.7
1931-32	2.7	60.7	— 57.9	4.4	4.8	— 0.4	7.1	65.5	— 58.3
1932-33	1.3	66.8	— 65.5	1.6	3.6	— 2.0	2.9	70.4	— 67.5
1933-34	1.0	58.1	— 57.0	0.8	7.1	— 6.3	1.8	65.2	— 63.3
1934-35	0.7	53.2	— 52.5	4.4	9.8	— 5.4	5.1	63.0	— 57.9
1935-36	0.9	38.3	— 37.3	6.4	9.0	— 0.5	7.3	47.3	— 37.8

1936-37	1.6	29.4	— 27.8	13.8	0.2	+ 13.5	15.4	29.6	— 14.3
1937-38	1.5	17.9	— 16.3	2.5	0.9	+ 1.5	4.0	18.8	— 14.8
1938-39	0.7	13.7	— 23.2***	1.5	0.9	+ 0.5	2.2	14.6	— 22.7
1939-40	0.7	37.2	— 44.6@	4.1	2.6	+ 1.4	4.8	39.8	— 43.2
1940-41	..	12.8	— 12.8	1.4	3.4	— 2.0	1.4	16.2	— 14.8
1941-42	..	2.1	— 2.1	3.7	9.2	— 5.4	3.7	11.3	— 7.5
1942-43	..	0.4	— 0.4	0.28	8.5	— 8.2	0.2	0.9	— 8.6
1943-44	0.3	0.2	+ 0.1	3.9	1.7	+ 2.2	4.2	1.9	+ 2.3
1944-45	0.1	..	..	22.6	0.4	+ 22.3	22.7	0.4	+ 22.3
1945-46	0.2	0.4	— 0.2	8.0	0.1	+ 7.9	8.2	0.5	+ 7.7
1946-47	8.1	1.5	+ 6.6	24.2	..	+ 24.2	32.3	1.5	+ 30.8
1947-48 .. .. (Nine months ended December 1947)**	8.6	..	+ 8.6	10.1	..	+ 10.1	18.7	..	+ 18.7
Total for 31 years from 1900-01 to 1930-31	714.5	166.7	+547.7	583.1	104.4	+478.7	1297.6	271.1	+1026.4
Total for 16 years from 1931-32 to 1946-47	20.5	393.6	—373.0†	104.1	60.8	+ 43.3	124.6	454.4	—329.7
Net Total from 1900-01 to 1946-47			+174.7			+522.0			+696.7

* Government of India Rupees are shown at face value.
**Provisional figures. Excluding figures for imports to and exports from the port of Karachi from October 1947.
*** Including 1,030,420 ounces of gold valued at Rs. 10,19 lakhs earmarked on account of purchases abroad.
@ Including 788,947 ounces of gold valued at Rs. 8,08,08,376 earmarked on account of purchases abroad.
† Including 1,819,367 ounces of gold valued at Rs. 18,27,08,376 earmarked on account of purchases abroad.
Since 1941-42 figures are on post-separation basis.

Source:—Statements VIII and IX from the Report on Currency and Finance for the year 1947-48 issued by the Reserve Bank of India.

agreed to certain conditions and regulations imposed upon them by the Act.

The total Note Issue in the commencement was little more than Rs. 10 crores, of which Rs. 4 crores, was supposed to be covered by securities of the Indian Government, and the balance by rupees or silver in full equivalence. The Notes were encashable on demand into rupees; but those issued by one circle, were not as a matter of right, encashable in another circle. This unavoidably impeded the popularity of the Notes which were the liability of the Government of India.

With the difficulties, however, that the Government of India experienced in regard to the last quarter of the XIX century in connection with Silver Rupee, and the changes which were made in the last decade this paper money assumed much greater importance. Both the coined rupee and the currency note were taken from and after 1900; the former printed on silver, and the latter on paper. Both were supposed to be convertible on demand into gold. But when the first considerable demand for such conversion was impending, the Government of India promptly disowned their obligation. Facilities were afforded for their encashment as between the different circles of issue; and conversion into metallic money, silver, or after 1900, gold, at a fixed rate was for a while also encouraged. But this was a relatively shortlived opportunity which was practically gone after 1914.

Before the beginning of World War I, the Note Circulation had reached the neighbourhood of Rs. 70 crores. Its convertibility was ensured by an equivalent Reserve, held partly in silver, coin or bullion, gold, coin or bullion, rupee securities of the Government of India and sterling securities, which occasioned considerable difficulties. The amount of the fiduciary portion of the Reserve was fixed absolutely. Of the metallic portion, silver, coin or bullion was held largely in India, while gold, coin or bullion, was held partly in India and partly in Britain.

The Paper Currency Reserve was regarded primarily to be a backing for conversion of the Notes, while the Gold Standard Reserve, built up out of the profits of Rupee coinage since 1899, referred to above, was intended for the conversion of Silver Rupees into Gold, or Sovereigns while they circulated. In practice, however, the two Reserves were closely interlocked and inter-changeable, particularly after a part of the G.S.R. came to be invested in Sterling Securities. In the event of any sudden demand for remittance from India, the Gold in the Paper Currency Reserve was first utilised, and

replaced when the demand had eased off, or by sale of securities and transfers from the Gold Standard Reserve. The rigidity of the Paper Money was slightly relaxed in the twenties. The Act was modified to permit an additional issue of Notes, uncovered by metallic or securities reserves, but covered by commercial bills of exchange, of an equal amount, subject to certain conditions about the rise in the bank rate. This permitted seasonal variations within fixed limits. When trade demand fell off the commercial bills would be paid up, and the notes issued against them automatically cancelled. It was, however, not sufficient to make the Note Issue, or the entire currency system as elastic in response to varying Trade demand as could be desired. The changes proposed by the Royal Commission while recasting the Note Issue in the Reserve Bank were meant to meet that difficulty.

A Royal Commission on Indian Currency and Finance (1926) held that the legal obligation to **convert Notes into Rupees** at any time must remain, though the conversion into gold was not insisted upon by that body, in marked contrast with the corresponding recommendation of the Fowler Committee in 1899. The new Notes, which the 1925 Commission proposed were to be issued by a Central Bank, eventually realised in the present Reserve Bank of India, need not be subject to such obligation of conversion into metallic money, but only into legal tender money, which might be notes of smaller denominations, or silver rupees at the option of the issuing authority. This tended to weaken the public confidence in these Notes,—though the events which followed the Commission's recommendations prevented any test being applied to this part.

The obligation was also to be imposed upon the Central Bank to provide Foreign Exchange; and as Sterling was then regarded as equivalent to Gold, this obligation in practice became identical with providing Sterling Exchange, even though Sterling had parted company with gold in 1931.

It must be added, however, that the Royal Commission referred to did not speak of Foreign Exchange being equivalent to Sterling only. Their actual words were "the obligation is to convert the Currency, not merely into Foreign Exchange, but into **Metallic Gold**; and it is an obligation that is not, as formerly, conditional and circumscribed, but absolute and unlimited. It has been undertaken by every other country that has adopted an effective Gold Standard, and we have satisfied ourselves that the present resources in the form of reserves at the disposal of the Government of India are adequate to enable the Currency Authority safely to undertake

TABLE II.

Note Issue and Circulation

Statement of the Affairs of the Reserve Bank of India.

(In lakhs of rupees)

	LIABILITIES.			ASSETS.				
Average of Friday Figures.	Notes in Circulation.	Notes held in the Banking Dept.	Total Liabilities (Total Notes Issued) or Assets.	Gold Coin and †Bullion.	Sterling Securities.	Rupee Coin*	Rupee Securities.	Percentage of Gold and Sterling Securities to Total Notes Issued.
1935-36	164,06	27,58	191,64	44,42	62,09	55,51	29,62	55,58
1936-37	175,81	25,81	201,62	44,42	69,57	64,01	23,62	56,54
1937-38	186,15	25,61	211,76	44,42	79,92	60,23	27,19	58,72
1938-39	182,36	28,28	210,64	44,42	66,95	67,11	32,16	52,91
	(7,97)	(1)	(7,98)					
1939-40	209,22	18.79	228,01	44,42	78,63	67,52	37,44	53,97
	(11,09)	(8)	(11,17)					
1940-41	241,41	17,26	258,67	44,42	129,92	35,87	48,46	67,39
	(13,38)	(20)	(13,58)					
1941-42	307,68	12,21	319,89	44,42	165,00	35,28	75,19	65,47
	(20,20)	(23)	(20,43)					
1942-43	513,44	11,80	525.24	44,42	319,11	22,33	139,38	69,21
1943-44	777,17	10,50	787,67	44,42	643,52	14,28	85,45	87,34
1944-45	968,69	10,93	979,62	44,42	863,73	13.52	57,95	92,70
1945-46	1,162,64	16,41	1,179.05	44,42	1,061,26	15,53	57,84	93,78
1946-47	1,222,96	32,61	1,255,57	44,42	1,133,88	19,43	57,84	93,85
1947-48	1,227,82	47,12	1,274,95	44,42	1,135,32	32,36	62,84	92,53

Figures for Burma shown within brackets below totals; figures for India only from June, 1942.
† Valued at the statutory rate of Rs. 21-3-10 per tola.
* Including Government of India one rupee notes from July, 1940.
Source:—Statement XL from the Report on Currency and Finance for the year 1947-48 issued by the Reserve Bank of India.
The total gross circulation of Notes in March 1948 had reached Rs. 1316.68 (cp. Statement XL from the Report on Currency and Finance 1947-48. p. 176.

the obligation with the measures of fortification at the time which we specify".

After the end of World War I, the three Presidency Banks were amalgamated into one Bank, the Imperial Bank of India, and the Note was then transferred for management to that new Institution. The Notes, however, still remained the liability of the Government of India and Note of the Bank. This, however, was changed when the Reserve Bank of India was established in 1935, as recommended by the Commission. The provisions of the convertibility and reserve against the Paper Money have been outlined in another section. The table II on page 28 gives the growth in the Note Issue and the composition of the Reserve against it from the foundation of the Reserve Bank to date.

Recommendations for Currency Reform by the Hilton-Young Commission

Let us now summarise the recommendations of the Royal Commission of 1925-26.

They considered that the ordinary medium of circulation should remain the currency note, and the silver rupee, and that the stability of the currency in terms of gold should be secured by making it directly convertible into gold. Unlike the Fowler Commission, however, they were against a free gold mint in India, as well as gold coinage in circulation. The sovereign and half-sovereign, till then legal tender, were to cease to be so. They suggested the Currency Notes—issued by a Central Bank—to be full Legal Tender.

The need for unity of policy to control currency and credit for achieving monetary stability required institution of a Central Bank in charge of both. This materialised later on as the Reserve Bank of India.

The Paper Currency should cease to be convertible by law into gold or silver coin. But the issuing Bank must maintain free inter-changeability of the different forms of legal tender currency; and Government must supply the necessary coins to the Bank on demand. For this purpose one-rupee notes should be re-introduced and should be full legal tender.

Notes other than those for one-rupee should be by law convertible into legal tender money, i.e. into notes of smaller denomination or silver rupees, at the option of the currency authority.

The Paper Currency Reserve, and Gold Standard Reserve should be amalgamated, and the proportions and composition

TABLE III

Total Money Supply in India and Pakistan

(In crores of rupees)

	March 1942†	March 1943	March. 1944	March. 1945	March. 1946	March. 1947	March. 1948
Notes in Circulation	382	644	882	1,085	1,219	1,242	1,304
Demand deposits of banks (scheduled and non-scheduled)**	232	387	543	624	735	711	762
Deposits with the Reserve Bank of India (excluding deposits of Burma Govt.)	63	87	167	392	643	562	457
Cash reserves of banks (scheduled and non-scheduled)**	54	65	78	120	120	116	121
Money Supply excluding rupee coin and small coin (1 plus 2 plus 3 minus 4)	623	1,053	1,514	1,981	2,477	2,399	2,402
Circulation of rupee coin		124@	137	147	166	168	155
Total Money Supply (excluding small coin) (5 plus 6)		1,177	1,651	2,128	2,643	2,567	2,557
Increase in Money Supply (excluding rupee coin and small coin)	191	430	461	467	496	—78	3
Percentage rate of increase	44.2	69.0	43.8	30.8	25.0	— 3.1	0.1

Items 1-7 figures as on last Friday. @ October 1943. **For some periods figures relating to non-scheduled banks are estimates, while figures since the partition are generally for India only. †Increases over the previous year.

Source:—Table 27, from the Report on Currency and Finance for the year 1947-48 issued by the Reserve Bank of India.

of the combined Reserve should be fixed by Statute. This is given later on while describing the constitution and functions of the Reserve Bank, the proposed Central Bank for issuing Currency Notes.

The Table on page 30 gives a picture of the total amount of Money of all kinds in circulation, and its growth since 1942-43 when Inflation began on a large scale. It includes deposits at call in all Banks, as well as Currency Notes and Rupee Coins in circulation. Fixed deposits—on which cheque currency cannot be developed, and small coins are not included.

VI. Peculiarities of the Indian Currency System

Having reviewed both the metallic and the paper portion of our currency system, some of its peculiar features may now be summed up.

As already pointed out, there is no standard of money, and, therefore, no definite objective norm or measure by which changes in values or developments in the National Economy can be gauged. The various Commissions and Committees have, from time to time, made simple or sophisticated suggestions for introducing the Gold Standard in one form or another. But the exigencies of British Imperialism prevented their recommendations materialising, or being given effect to in the spirit in which they were made.

The rupee itself, though still in circulation, is not a standard coin. It is only a fraction of the pound sterling; and the only guarantee of its stability in that regard is the statutory obligation placed upon the Reserve Bank of India to maintain a fixed rate of exchange with the pound sterling. As the latter itself is a varying quantity, however, since its going off gold in the Summer of 1931; and as its variations, particularly during the War, have been substantial, the fixity of the Rupee Setrling ratio is, by itself, no real guarantee of the stability of the Indian currency system.

The pound sterling, it may be added, has been maintained at a fixed ratio to the dollar, by agreement with the war-time ally—the United States. But even the dollar has depreciated 40% since 1933, so that the pound sterling has depreciated, in the terms of the dollar, from \$4.87 = £1. to \$4.05 = £1. In reality, therefore, the pound is worth, in terms of the 1930 price level, somewhere about 3/8ths, if not less than its original gold value.

Nowhere, however, in the world of Commerce today, is there anything like a real gold standard as it had functioned

in Britain between 1819 and 1914. There is no stable standard money either. It may, therefore, not be regarded as a feature peculiar to the Indian Currency System. But whereas in other countries there is a tendency to work back to a previous norm or standard, however impossible that norm may seem to be to attain, in India there is no such norm, and has never been during the last 100 odd years. There is, therefore, no fixed goal to be realised. The Rupee, if it is to have anything like a standard place in International Exchange, must, first of all, be dislinked and separated completely from the pound sterling, and emancipated from all the complications or vicissitudes that hang around the pound sterling. The inherent strength of India's National Economy would then gradually assert itself. And if the country's currency system, both metallic and paper money, is properly managed, in the interests of this country and its planned economy, it is not at all improbable that the rupee will regain the position it had in the last century, as something definite and capable of a fixed value in exchange that can be easily maintained. India is today a creditor country, though her dues are not likely to be realised in the near future. She has no longer a heavy burden of "Home Charges" to meet allround. And though she is, for the moment, obliged to import heavily food and capital goods, if the plans now laid are achieved, she would soon show an export surplus which would add further strength to her standard of currency. It would once again restore the inward flow of specie, and facilitate her maintenance of a stable ratio in exchange without any detriment to her own interests in trade or industry.

The subsidiary coinage in circulation in India has not been considered in this review, not because it does not exist, but because it is relatively unimportant. The rupee itself has been debased till its silver content is hardly half of what it used to be. Silver has risen four or five times its pre-war value. The old time possibility of deriving any profit from the coinage of rupees or subsidiary silver coins no longer exists. For sentimental reasons it may be that India will continue to use rupees in large quantities in daily transactions. But, as a fuller knowledge of the place of metallic or representative money in a progressive economy spreads amongst the people, and as the suspicion which used to haunt them before the War of the manipulation of the rupee for the benefit of Non-Indian interests disappears, the use of paper substitutes for metallic money, and still more of bank deposits in the shape of cheque currency, would become more and more popular. Further, if banking facilities within the country, widen and deepen, as suggested hereafter, so as to meet the peculiar

requirements of this country, the use of metallic money, and all the waste of capital locked up in reserve to maintain convertibility of the Paper Currency, that such use may involve, would be progressively avoided.

In regard to the Paper Money or Currency Notes in circulation, apart from the lack of a fixed standard of value in terms of which currency notes are expressed, there are two glaring difficulties which must be mentioned at this stage. These are unlimited legal tender but convertible only in legal tender, and not in gold or silver. This is a great weakness, especially among a people ruled by aliens, and suffering from suspicion of being exploited for foreign benefit. The dependence upon Sterling of the currency note for convertibility in the shape of sterling securities, is another, and utterly unnecessary source of weakness. It provides no greater safety for the Indian Paper Money to the extent that it is covered by Sterling Securities. On the contrary, it is a source of weakness because of the likely vicissitudes of the pound sterling itself arising out of economic as well as political factors. At the present time more than half the total issue is covered only by the sterling securities, which are for all practical purposes unrealisable; and therefore the notes backed by them inconvertible.

Apart from this, the monetary system in India has all along been lacking in the degree of elasticity, which provides for automatic expansion or contraction in accordance with the varying needs of trade, and of a growing economy. Rupees, once put into circulation, do not return automatically when the need for them is over. They used to be an excellent means of hoarding, in the shape of silver ornaments, which could be liquidated only in times of severe distress when circulation would need to be contracted, not expanded. If, on the other hand, more rupees were needed for circulation, they could only come from new minting of silver which would have to be imported from abroad. This would needlessly affect our trade balance. And as for Paper Money, since beyond a certain figure, additional Notes could only be put into circulation by providing more gold or rupees in the Reserve, or adding to the volume of rupee or sterling securities, these would be no expansion in response to genuine trade demand; but only a means to inflation. Contraction, on the other hand, of this currency has never happened on a large scale; and will not happen in the future unless and until the Note Issue is linked directly with the country's productive organisation and distribution arrangements.

TABLE IV

Total Amount of Cheques cleared since 1919-20

(In lakhs of Rupees)

Year	Bombay	Calcutta	Delhi	Kanpur	Karachi	Lahore	Madras	Total
1919-20	8,83,02	10,55,76	—	—	23,13	—	33,95	19,95,86
1924-25	6,21,66	9,54,11	—	5,72	46,13	5,57	55,96	16,89,15
1929-30	7,93,66	9,60,97	—	7,56	26,49	8,17	82,19	18,79,04
1934-35	6,89,17	8,75,69	—	11,51	28,96	10,43	56,22	16,71,98
1939-40	8,83,97	11,54,03	20,35	14,22	37,53	11,14	99,94	22,52,91
1940-41	8,02,32	10,08,53	28,53	19,20	46,76	16,33	1,08,65	20,72,60
1941-42	10,48,60	12,33,61	41,35	29,59	58,80	26,71	1,36,41	26,66,34
1942-43	13,45,23	10,74,66	81,94	56,21	77,51	48,76	1,31,40	29,79,09
1943-44	19,66,69	17,18,61	1,19,16	1,01,06	1,01,36	77,80	1,96,80	45,79,22
1944-45	22,36,97	23,51,59	1,29,94	1,12,95	1,24,54	95,94	2,27,37	56,26,80
1945-46	24,87,60	28,26,21	1,46,02	1,13,47	1,45,49	1,03,39	2,98,23	65,72,37
1946-47	28,59,08	28,42,25	1,56,37	1,42,66	2,01,82	1,36,92	3,78,00	72,21,38
1947-48	24,52,64	25,99,96	1,26,46	1,09,83	2,74,81	49,54	3,47,94	64,80,14

Contrary to the trend noticed since 1940-41, the total amount of cheques cleared showed a steep fall during the year from Rs. 7,221.38 crores in 1946-47 to Rs. 6,480.14 crores in 1947-48. The heaviest fall in total clearings was registered at Bombay.

Sourse: Report on Currency and Finance p. 166, 1947-48.

Note: The total for the years 1939-40—1947-48, also includes the figures for other centres.

Reference has been made in the preceding review to a provision introduced in the twenties for linking a fraction of the Paper Currency with the seasonal expansion of trade demand for money. That, however, related to a very small fraction of the total Note circulation. It was, besides, subject to a maximum of Rs. 12 crores, about 5% of the total circulation as well as conditioned in other ways. All that did not make for a real elasticity in the monetary system. Paper Money would be unable to render its full service to the country's economy, so long as the reserve provisions are rigid as today, with sterling securities predominating; and so long as a close contact with the active features of the country's economy, particularly in regard to domestic and foreign trade, is not provided.

There is, next, no co-ordination between the total value of money of all kinds in circulation and the aggregate national economy. There is very little of the so-called "deposit currency", which every modern commercial country tends to develop more and more. It is the one element likely to expand or contract in accordance with the general trade needs.

Statistics of the Clearing House in India suggest relatively small proportion of the domestic trade of the country being settled by means of cheques or bills. (Refer to Table IV on page 34.)
But even so it seems to be far more considerable than the paper and metallic money put together. If the metallic portion of the currency is to be economised, and if the entire monetary system is to be made to function as integral part of the aggregate National Plan, it is of the utmost importance that habits and facilities of banking, and therefore the use of deposit currency, be encouraged to the utmost possible.

There is, moreover, no correlation, consciously devised and maintained between the total volume of money in circulation,—whether metallic or otherwise, and the economic needs of the country, its productive capacity, or distribution requirements. At the present price-level, notwithstanding a fall in the quantum of production, in agriculture as well as industry, the total wealth annually produced in the country may well be put at something over Rs. 6,000 crores for the Indian Union. If this volume of goods is to be exchanged only once, from the producer direct to the consumer, without any intermediary, the total money needed would be a corresponding figure, with due allowance for the rapidity of circulation, and the use of substitute forms devised. The present volume of production is, however, expected to increase, especially if a planned programme of progressive development takes effect. The volume of money—or the medium of exchange—needed would be

somewhere about Rs. 3,000 crores, if we allow for 3 intermediaries of the village trader, the wholesale merchant or exporter, and the final consumer; and each money unit to do the work of ten by its velocity of circulation. India, however, does not produce her own requirements of gold (except in negligible proportions) or silver within the country. Our present total circulation may be taken to be Rs. 2,500 crores in all forms of money. But that is said to have caused severe inflation. If that cry is to be avoided, our monetary system will have to be so devised as to be not only in clear co-relation with the total value of wealth to be exchanged, making allowance for the various intermediaries and rapidity of circulation; but also the facilities for substitute monies in the shape of Bank cheques or deposit currency, or other means that may be devised.

It would be futile to lay down any definite formula for calculating the total volume of money or currency needed by India. It is, however, important to emphasise this point, as in planned economy it would be impossible to leave the working of the Price Mechanism to function as erratically and unco-ordinatedly as it has been doing under the present system of ad hoc regulation or chaotic laissez-faire. The price mechanism is, in the ultimate analysis, only a means to effect exchange between producer and consumer, or rather secure adequate and regular distribution of the means of satisfying the wants of man, provide for all the services, amenities and utilities which go to make up the modern living standard in a modern civilised country, and maintain in smooth working order the entire productive organisation. Viewed thus, there is no sanctity in the price level prevailing at any given moment. It may be fixed at any point that the exigencies of the country's economy may demand. The factors causing variations will be more than neutralised, if the changes in the price-level are made exclusively in response to the needs of the local economy, and not dictated by any extraneous factors.

VII. Banking and Credit

Mention has been made in an earlier section of the need to co-relate Banking Currency with the Metallic or Paper Currency used in this country. The Development and working of Banks and Banking must, therefore, next claim our attention.

Banking in all its variety seems to have been known and practised in India from time immemorial. In the modern form, however, in which that occupation is most commonly under-

stood today, it may be said to have begun in the last century under the influence of the foreign trading corporations, which were by that time asserting themselves in the economic life of the country. Financing of trade was the principal urge for developing modern type of commercial banking. Various types of banks and banking business have been developed since then in this country, into the details of which it is unnecessary to go. The principal types that dominate, so to say, the banking business of the country today are:—

(1) The Reserve Bank of India—a Central Statutory Corporation for the management of the country's credit and currency.

(2) The Imperial Bank of India, another National institution, with a special Charter or Statute of its own.

(3) Exchange Banks, mostly of non-Indian registration.

(4) Indian Joint Stock Banks (Scheduled Banks).

(5) Indigenous Bankers, Shroffs, or Money-lenders.

(6) Co-operative Credit Societies (mainly agricultural).

(7) Land Mortgage Banks.

(8) Industrial Finance Corporation.

(1) Reserve Bank of India

The Reserve Bank of India is, historically speaking, the last link in the chain; but it stands at the very apex as the Central Monetary and Credit Organisation of the country.

A Bill to establish a Reserve Bank in India, as an essential preliminary to the introduction of the scheme of Reforms recommended by the Currency Commission, was first introduced in the Indian Legislature in 1927; but owing to opposition of vested interests, it was dropped at the time. The proposal remained in cold storage for seven years, at the end of which it was again brought forth. But by this time, its complexion had slightly changed. From being conceived as a purely Central Currency and Credit Organisation of the country, it had become a preliminary essential to the introduction of Provincial Autonomy and Federal system of Government in India. Being conceived as a sort of bulwark against any hare-brained schemes of currency reform by any Government falling into the hands of irresponsible nationalists (?), and being taken to be a guarantee for the vested interests against any proposals for repudiation or cancellation of the Public Debt,—as was feared to be the Congress intentions,—the Bank was made an independent, Statutory Corporation, owned by

private shareholders, but controlled by Government in the public interest. The Legislature passed that Bill, which received the assent of the Governor-General on March 6th, 1934.

The main purposes for which the Bank was constituted were:—

(a) taking over the management of the Currency System of the land from the Governor-General-in-Council; and

(b) of carrying on the business of banking for Government as well as for the country collectively.

The original share capital of the Bank was Rs. 5 crores divided into shares of Rs. 100 each, all fully paid-up. To guard against undue concentration of voting power, in any one hand, the maximum number of votes any one shareholder could have was restricted to 10, every five shares carrying the right of one vote. The entire capital is owned by private shareholders, except the small amount reserved by Government to be disposed of at par to a Director of the Central Board, if required for qualifying to become a Director.

Five Share Registers were to be maintained at Bombay, Calcutta, Delhi, Madras and Rangoon, and the nominal value of the shares assigned to each centre was fixed at Rs. 140 lacs for Bombay, Rs. 145 lacs for Calcutta, Rs. 115 lacs for Delhi, Rs. 70 lacs for Madras and Rs. 30 lacs for Rangoon. Since the separation of Burma, Rangoon is eliminated.

No person can be registered as a shareholder who is not:—

(a) domiciled in India or Burma and either an Indian or Burman subject of His Majesty; or a subject of a State in India or Burma, or

(b) a British subject ordinarily resident in India or Burma, and domiciled in the United Kingdom, or in any part of His Majesty's Dominions, the Government of which does not discriminate in any way against Indian or Burman subjects of His Majesty; or

(c) a company registered under the Indian Companies Act 1913, or a society registered under the Co-operative Societies Act; or a Scheduled Bank or a Corporation or a company incorporated by or under an Act of Parliament or any law for the time being in force in any part of His Majesty's Dominions, the Government of which does not discriminate in any way

against Indian or Burman subjects of His Majesty and having a branch in British India or in Burma.

Since the separation of Burma in 1937, consequential modifications have been made in this section of the Act.

At a general meeting of the Bank or at an election of members of a Local Board, each shareholder has one vote for each five shares held by him subject to a maximum of ten votes.

The share capital of the Bank may be increased or reduced on the recommendation of the Central Board, with the previous sanction of the Central Government and with the approval of the Central Legislature.

After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation funds, and such other contingencies as are usually provided for by bankers, and after payment out of the net annual profits of a cumulative dividend at such rate, not exceeding five per cent per annum, as the Central Government may fix at the time of the issue of shares, a portion of the surplus is allocated to the payment of an additional dividend as prescribed by the fourth schedule. The balance of the surplus is paid to the Central Government. If, however, at any time, the reserve fund is less than the share capital, not less than Rupees fifty lakhs of the surplus, or the whole of the surplus, if less than that amount, must be allocated to the reserve fund.

Management of the Bank.

The general superintendence and direction of the Bank is entrusted to a Central Board of Directors consisting of 16 members, namely:—

(a) a Governor and two Deputy Governors appointed by the Central Government after consideration of the recommendations made by the Board in that behalf;

(b) four Directors nominated by the Central Government;

(c) eight Directors elected on behalf of the shareholders on the various registers mentioned above. Two Directors each are elected for the Bombay, Calcutta and the Delhi registers and one each for the Madras and the Rangoon registers, and

(d) one Government Official nominated by the Central Government.

For each of these five areas there is a Local Board consisting of:—

(a) five members elected from amongst themselves by the shareholders who are registered on the register for that area and are qualified to vote, and

(b) not more than three members nominated by the Central Board from amongst the shareholders registered on the register for that area.

The Governor and Deputy Governors are executive heads, holding office for a term, not exceeding five years. They are eligible for re-appointment.

Business Open to the Bank

The Bank is authorised to carry on and transact the following commercial business, viz:—

I. (a) accepting of money on deposit without interest,

(b) purchase, sale and re-discount of bills of exchange and promissory notes with certain restrictions,

(c) making of loans and advances, repayable on demand, but not exceeding 90 days, against the security of stocks, funds and securities other than immovable property, against gold coin or bullion, or documents of title to the same, and such bills of exchange and promissory notes as are eligible for purchase or rediscount by the Bank,

(d) purchase from and sale to scheduled banks, of sterling in amounts of not less than the equivalent of Rs. 1 lakh,

(e) making of advances to the Central and Local Governments, repayable in each case not later than three months from the date of the advance,

(f) purchase and sale of Government securities of the United Kingdom maturing within ten years from the date of purchase,

(g) purchase and sale of securities of the Government of India, or of a Local Government, of any maturity or of a Local Authority in British India, or of certain States in India which may be specified.

Government's Agency Business

II. The Bank must act as Agent for the Government of India or any Local Government or State in India for the:—

(a) purchase and sale of gold and silver,

(b) purchase, sale, transfer and custody of bills of exchange, securities or shares,
(c) collection of the proceeds, whether principal, interest or dividends, of any securities or shares,
(d) remittance of such proceeds by bill of exchange payable either in India or elsewhere, and
(e) management of public debt.

The Bank accepts monies for account of the Central and Local Governments, and carries out their exchange, remittance, and other banking operations. It manages the Public Debt on such conditions as may be agreed upon. For the management of the Public Debt the Bank is paid a Commission of Rs. 2,000/- per annum for every Rs. 1 crore of Debt.

The Law requires the Bank to sell sterling at a rate not below 1sh. 5.49/64d. and buy sterling at a rate not more than 1sh. 6.3/16d. per rupee. It is thus obliged to maintain the fixed rupee-sterling ratio. This is, however, not quite what the Commission had recommended, as sterling is not gold, nor nowadays convertible into gold freely. It is, in fact, this provision which has been abused to lock up such huge resources of India into the practically unrealisable Sterling Balances of the War-time growth.

It may be added that no person is entitled to demand to buy or sell an amount of sterling less than ten thousand at a time. This enables the Bank to meet genuine trade needs and yet guard against hoarding.

III. Monopoly of Bank Notes Issue

The Bank is given a monopoly to issue Bank Notes which are full legal tender in British India. To begin with, however, it was required to take over and issue Currency Notes of the Government of India supplied by the latter, who from the date of such transfer were not to issue any such notes. As soon as the Bank got into working order Rs. 5 crore worth of Rupee Securities were transferred by the Government to the Bank to be allocated to the Reserve Fund.

To guard against confusion or complication, the issue of Bank Notes was to be conducted by a separate Issue Department of the Bank, wholly distinct from its Banking Department. Its assets are free from any liability of the Bank, other than those in regard to Notes only. Weekly publication of Accounts every Thursday of both these Departments is compulsory.

No Notes are issued to the Banking Department or to any other person, except in exchange for other Bank Notes, or for

TABLE V

Various Denominations of Notes in Circulation.

(in lakhs of Rupees)

Year ended (31st March)		Re. 1	Rs. 2	Rs. 2-8	Rs. 5	Rs. 10	Rs. 20	Rs. 50	Rs. 100	Rs. 500**	Rs. 1,000**
1921	..	9,52	..	51	14,05	52,67	3	3,84	47,22	2,53	17,81
1925	..	4,15	.4	4	15,83	68,57	2	2,61	63,87	2,32	13,11
1930	..	35	..	1	20,97	69,08	2	1,60	58,88	84	10,78
1935	..	32	..	1	25,28	69,31	1	1,34	62,35	53	12,84
1940	..	32	..	1	44,03	97,83	1	61	80,44	33	17,64
1941	..	32	..	1	62,23	134,89	1	51	113,13	38	28,20
1942*	..	32	..	1	106,74	218,21	1	46	202,82	52	54,07
1943*	..	32	5,56	1	142,48	302,93	1	37	291,54	60	90,99
1944*	..	32	9,73	1	148,80	363,38	1	30	382,51	32	100,93
1945*	..	32	14,45	1	153,87	425,37	..	25	495,84	26	113,37
1946*	..	32	25,42	1	197,09	545,40	..	19	488,71	3	1,31
1047*	..	32	33,09	1	195,10	557,70	..	16	540,11	3	1,12
			2.5%		14.7%	42.0%			40.7%		.1%

* India notes only.

** Demonetised from 12th January 1946.

Source:—Report on Currency & Finance 1948 issued by the Reserve Bank of India. (page 183).

such coin, bullion or securities as are allowed to be part of the Reserve.

The denominations fixed by law of Notes are:—Five rupees, ten rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, and ten thousand rupees. Since January 12th, 1946, thousand and ten thousand rupee notes have been demonetised, and thrown out of circulation; while rupees fifty notes have been long since discontinued. (See Table on page 42.)

Assets of the Issue Department

The Assets of the Issue Department consist of gold coin, gold bullion, sterling securities, rupee coin and rupee securities. The aggregate of all these must equal the total of the Department's liabilities in respect of the total notes issued.

Of the total assets, not less than 40% must consist of gold coin, gold bullion, or sterling securities. Of these gold coin and gold bullion must at any time be not less than forty crores of rupees in value. Though sterling was classed, quite improperly, along with gold, and has consequently resulted in our present problem of Sterling Balances, the fixation by law of a minimum reserve in gold of Rs. 100 crores, corresponded to 40% of the total notes in circulation at the time the Act was passed.

Of the gold held in reserve 17/20ths must be kept in India, and the whole of it wherever held must be in the custody of the Bank. Cash balances held abroad are to be considered as part of the Sterling Securities. The Gold in the Gold Standard, and that in the Paper Currency Reserve, were incidentally amalgamated, and transferred to the Bank.

The balance of the assets must be rupee coin, rupee securities, and such bills of exchange and promissory notes, payable in British India, as are eligible for purchase by the Bank. Rupee securities must not exceed one-fourth of the total assets, or Rs. fifty crores whichever is greater, or, with Government's previous sanction, of such amount plus Rs. ten crores. The Bills of exchange and promissory Notes, thus introduced in the Reserve, provide the only element of elasticity in our paper currency system.

For the purpose of the currency reserve, Gold is valued at 8.47512 grains of fine gold per rupee. This is far below the present market price of that metal. The present value of the Rs. 44.4 crores of gold in our Paper Currency Reserve would be over Rs. 135 crores. Rupees are valued at face value notwithstanding the reduction in silver content of the rupee; and rupee at the market rate for the time being.

The Act makes arrangements for the supply of rupee coins to the Bank against Notes. In future such coins will only be issued by the Bank and not by Government, though the latter retained the right of coinage for themselves.

Bank Rate

In order effectively to control the credit as well as currency system of the country, and to co-relate the two in the interests of the national economy, the Bank is empowered to have the cash balances of all the Scheduled Banks. Each Bank must maintain an interest-free balance of not less than 5% of its demand liabilities, and 2% of the fixed deposits, subject to a minimum of Rs. 1 lakh.

The Bank must make public from time to time the standard rate at which it is prepared to buy or re-discount bills of exchange or other commercial papers eligible for purchase under the Act. This is the foundation of the so-called Open Market operations of the Bank. The Bank Rate functions as the regulating norm round which the Money Market as a whole adjusts itself. Ever since its inception, a policy of cheap money, and, therefore, a low rate of interest has been followed by the Bank, which has, however, brought no real industrial resurgence in the country.

IV. Agricultural Credit Department

This is intended:—

(a) to maintain an expert staff to study all questions of agricultural credit, and

(b) to co-ordinate the Bank operations in connection with agricultural credit, and its relations with provincial co-operative banks or other banks engaged in the business of agricultural credit.

This Department cannot, indeed, render direct assistance to Agriculture, though it is the country's largest single, and the most productive, industry; and so cannot help in its revival, as one might expect. For an effective revival, Indian agriculture needs not only capital, or the tools and instruments, equipment or facilities which capital can provide; but, much more, a radical reorganisation and reconditioning of the entire system of land-holding and cultivation, without which all other improvements would only be so much patch work. This is explained more fully in other volumes in this Series, and so no more need be said on that subject here.

The Reserve Bank's assistance to Agriculture is rendered through the Scheduled Banks, in so far as the latter them-

selves engage in such operations; or, more commonly, through the Provincial Co-operative Banks. Agricultural Bills, endorsed by some intermediary Banks, are limited to those drawn to facilitate or expedite seasonal agricultural operations, or to market crops. The maximum period, again, for which such help can be given, is limited to a relatively short period, sufficient, it is thought, to enable the agriculturist to tide over a temporary or seasonal shortage of funds.

Restrictions on Business

The Reserve Bank is forbidden, subject to exceptions allowed in ss. 17, 18 and 45 of the Act, to:—

(1) engage in trade or otherwise have a direct interest in any commercial, industrial or other undertaking. If any interest is acquired in the course of the satisfaction of any claims of the Bank, it must be disposed of at the earliest opportunity;

(2) purchase its own shares or those of any other company, or grant loans upon the security of any such shares;

(3) advance money on mortgage of immovable property, or become the owner of immovable property, except its own business premises and residences for its officers and servants;

(4) make loans or advances;

(5) draw or accept bills payable otherwise than on demand;

(6) allow interest on deposits or current accounts.

The Act requires the Bank, at the earliest practicable date, and in any case within three years from its start, to report to Government, with proposals, if it thinks fit, for legislation, on the following matters, namely:—

When the Bank is of opinion that the international monetary position has become sufficiently clear and stable to make it possible to determine what will be suitable as a permanent basis for the Indian monetary system, and to frame permanent measures for a monetary standard.

Nationalisation of Reserve Bank

Provision is made for converting the Bank into a Government concern by a special section of the Act. In the event of the Bank being ordered to be liquidated or wound up, the

TABLE VI-A.

Statement of Affairs of the Reserve Bank of India, Banking Department, as on the 10th Sept. 1948

LIABILITIES	Rs.	ASSETS	Rs.
Capital Paid up	5,00,00,000	Notes	30,74,21,000
Reserve Fund	5,00,00,000	Rupee Coin	6,92,000
Deposits:—		Subsidiary Coin	1,59,000
(a) Government			
Central Government	216,43,44,000	Bills Purchased & Discounted:—	
Other Governments	17,31,98,000	(a) Internal	36,23,000
		(b) External	—
(b) Banks	97,39,63,000	(c) Govt. Treasury Bills	3,88,53,000
(c) Others	56,98,44,000		
		Balance held abroad*	308,73,40,000
Bills Payable	3,98,35,000	Loans & Advances to Govts.	10,00,000
		Other Loans and Advances	6,25,000
Other Liabilities	7,80,62,000	Investments	63,34,68,000
		Other Assets	2,60,65,000
	4,09,92,46,000		409,92,46,000

*Includes Cash & Short term Securities.
Dated the 15th Day of September 1948.

TABLE VI-B.

An Account pursuant to the Reserve Bank of India Act 1934, for the week ended the 10th day of September 1948
Issue Department

LIABILITIES	Rs.	Rs.	ASSETS	Rs.	Rs.
Notes held in the Banking Dept.	30,74,21,000		A. Gold Coin & Bullion:		
			(a) Held in India ..	42,71,91,000	
Notes in circulation ..	12,18,01,28,000		(b) Held outside India Sterling Securities	796,64,28,000	
Total Notes issued		12,48,75,49,000	Total A. ..		8,39,36,19,000
			B. Rupee Coin ..		45,07,81,000
			Govt. of India Sterling Securities ..		3,64,31,49,000
			Internal Bills of Exchange & Other Commercial Paper		
Total Liabilities ..		12,48,75,49,000	Total Assets:— ..		12,48,75,49,000

Ratio of Total of A to Liabilities: 67.216 per cent.

C. R. TREVOR,
Deputy Governor.

Reserve Fund and Surplus assets, of the Bank must be divided between Government and the shareholders in the proportion of three to one respectively. But the total amount payable to any shareholder must not exceed the paid up value of the shares held by him by more than one per cent for each year after the commencement of this Act subject to a maximum of 25%. It was under this Section that the capital of the Bank held by private individuals was transferred to the State, by special legislation in September, 1948. (See Tables on 46, 47.)

(2) The Imperial Bank of India

The Imperial Bank of India is a wholly private corporation founded in 1920 by the amalgamation of the old Presidency Banks. It was given a good deal of Government business, which, however, was withdrawn from it on the foundation of the Reserve Bank. An agreement was made with the latter whereby the Imperial Bank was continued as a private Bank for another fifteen years at the end of which that institution will also be nationalised, very likely in 1949.

Government Agency Business

The Imperial Bank of India becomes the sole agent of the Reserve Bank at all places in British India where a branch of the Imperial Bank was in existence at the commencement of the Reserve Bank of India Act, 1934, and where there was no branch of the Banking Department of the Reserve Bank.

In consideration of the performance of the Agency duties, the Reserve Bank pays to the Imperial Bank during the first ten years of the agreement a commission of 1/16 per cent. on the first 250 crores, and 1/32 per cent. on the remainder of the total of the receipts and disbursements dealt with annually on account of Government. As for the remaining five years the remuneration to be paid to the Imperial Bank is to be determined on the basis of the actual cost to the Imperial Bank of India, of doing this agency work.

The first ten years of the agreement having come to a close in 1945, the rates of remuneration were revised as from April, 1945. The revised rates also allow commission to the Imperial Bank of the turnover of Government account at 1/16th% on the first 150 crores, 1/32 of one per cent. on the next 150 crores (in place of the remainder), 1/64th of one per cent. on the next 300 crores, and 1/128th of one per cent. on the remainder of the total receipts and disbursements dealt with annually on account of Government.

Reserve Bank Agency Business

In consideration of the maintenance by the Imperial Bank of India of branches not less in number than those existing at the commencement of the Reserve Bank of India Act, the Reserve Bank of India shall, until the expiry of 15 years, make to the Imperial Bank the following payments:—

(1) during the first five years of this agreement Rs. 9 lacs per annum;

(2) during the next five years of the agreement Rs. 6 lacs per annum; and

(3) during the next five years of the agreement Rs. 4 lacs per annum.

Other Business

The Act constituting this Bank has defined the various types of business which the Bank may transact. Any business not expressly permitted is forbidden.

Briefly stated, the main classes of business sanctioned are:—

1. Advancing money upon the security of:—
   (a) Stocks, etc., or Trustee Securities, and shares of the Reserve Bank of India.
   (b) Securities issued by State-aided Railways.
   (c) Debentures, or other securities issued by a district or municipal board, or any State in India.
   (d) Debentures of companies with limited liability registered in India or elsewhere.
   (e) Goods, or documents of title thereto, deposited with, or assigned to the Bank.
   (f) Goods hypothecated to the Bank against advances.
   (g) Accepted Bills of Exchange or Promissory Notes.
   (h) Fully paid shares of Companies with limited liability, or immovable property or documents of title relating thereto, as collateral security where the original security is one of those specified in 'a' to 'f', and, if authorised by the Central Board, in 'g'.

2. Selling of promissory notes, debentures, stock-receipts, bonds, annuities, stock, shares, securities or goods or documents of title to goods deposited with or assigned to the Bank as security for advances.

3. With the sanction of the Provincial Government, advancing money to Courts of Wards upon security of estates in their charge, for the period not exceeding nine months in the case of advances relating to the financing of seasonal agricultural operations or six months in other cases.

4. Drawing, accepting, discounting, buying and selling of bills of exchange, and other negotiable securities.

5. Investing the Bank's funds in the securities referred to in (1) a, b, c, and d.

6. Making, issuing and circulating of bank post-bills and letters of credit to order or otherwise than to the bearer on demand.

7. Buying and selling gold and silver.

8. Receiving deposits.

9. Receiving securities for safe custody.

10. Selling and acquiring such properties as may come into the Bank's possession in satisfaction of claims.

11. Transacting agency business on commission and the entering into of contracts of indemnity, suretyship or guarantee.

12. Acting as Administrator, for winding up estates.

13. Drawing bills of exchange and granting letters of credit payable out of India.

14. Buying of bills of exchange payable out of India at any usance not exceeding nine months in the case of bills relating to the financing of seasonal agricultural operations, or six months in other cases.

15. Borrowing money upon security of assets of the Bank.

16. Subsidizing the pension funds of the Presidency Banks; and

17. Generally, the doing of the various kinds of business including foreign exchange business.

(a) The Bank must not make any loan or advance:—

1. For a longer period than six months, except as provided in clauses 3 and 14 above;
2. upon the security of its own stock or shares;
3. save in the case of estates specified in Part 1 (Courts of Ward) upon mortgage or security of immovable property or documents of title thereof.

(b) The amount which may be advanced to any individual or partnership is limited.

TABLE VII

Statement of Affairs of the Imperial Bank of India as on 10th September, 1948.

LIABILITIES

	Rs.	Rs.
1. **Capital:**		
(a) Authorised ..	11,25,00,000	
(b) Issued & Sub-scribed ..	11,25,00,000	
(c) **Called up:**		
(i) fully paid ..	3,75,00,000	
(ii) paid up (1,50,000 shares of 500 each) ..	1,87,50,000	5,62,50,000
2. Reserve Liability of the Shareholders ..		5,62,50,000
3. Reserve Fund ..		6,25,00,000
4. Fixed Deposit, Saving Bank Current & Other Accounts ..		287,98,32,000
5. Loans against Securities per contra ..	Nil	—
6. Acceptances for Constituents ..	Nil	—
7. Sundries ..		96,91,000
TOTAL ..		300,82,73,000

ASSETS

	Rs.	Rs.
1. Investments:—		
(i) Government Securities ..	153,88,31,000	
(ii) Authorised investment ..	10,29,00,000	164,17,31,000
2. Advances:—		
Loans ..	15,68,54,000	
Cash Credit & Over-drafts	52,65,65,000	
Bills discounted & Purchased ..	3,88,96,000	72,23,15,000
3. Liability of Constituents for Acceptance per contra ..	Nil	
4. Dead Stock ..	1,55,08,000	1,55,08,000
5. Sundries ..	1,36,46,000	1,36,46,000
6. Bullion ..	Nil	
7. Cash in hand with the Reserve Bank ..	55,06,07,000	
Cash with other Banks	6,44,66,000	61,50,73,000
TOTAL ..		300,82,73,000

* Times of India Dated 17-9-48.

(c) Discounts cannot be made or advances on personal security given unless such discounts or advances carry with them the several responsibilities of at least two persons or firms, unconnected with each other in general partnership.

(d) Discounts cannot be made or advances given against any security not being a security in which a trustee may invest trust money under the Indian Trusts Act, 1882.

3. The Exchange Banks

Besides these two Central Banks, which are either already nationalised in regard to ownership and management, or will soon be, and which are concerned principally with public banking business, the bulk of the country's banking business, is conducted by the so-called Scheduled Banks, including Exchange Banks as well as Indian Joint Stock Banks. The former who were earlier in the field, were pioneers in the modern type of banking business, and were confined largely to financing the foreign trade of India. The latter have grown in imitation of the former, and generally conduct their business on the same lines.

The Banks carrying on Exchange business in India are merely branch agencies of Banks having their head offices in London, on the Continent of Europe, in the Far East like Japan, and the United States. Originally their business was confined as just remarked almost exclusively to the financing of the external trade of India; but in recent years most of them, while continuing to finance this part of India's trade, have taken an active part in the financing of the internal portion also at the places where their branches are situated.

At one time the Banks carried on their operations in India almost entirely with money borrowed elsewhere, principally in London which was considered to be the central money-market of the world. The home offices of these Banks attracted deposits for use in India by offering rates of interest comparatively higher than the English Banks were able to quote. Within recent years, however, they have found it possible to attract deposits in India on quite as favourable terms as can be done in London and so their Indian deposits are actually in excess of those held abroad. A very large proportion of the trade finance by Exchange Banks is now carried through by money actually raised in India.

The following statement taken from the Statistical Tables relating to Banks in India, published by the Reserve Bank of India, shows how considerable is the volume of deposits held by these foreign Banks, how rapidly they have expanded, and the character of the business done by them.

TABLE VIII

Capital, Reserves, Deposits and Cash Balances of the Exchange Banks.

As on		No. of Banks	Capital & Reserves	Deposits		Cash Balances	
			Total	Out of India	In India	Out of India	In India*
			£(1,000)	£(1,000)	Rs. (1,000)	£(1,000)	Rs. (1,000)
31st Dec.	1920	15	90,217	513,671	74,80,71	84,197	25,17,53
,, ,,	1930	18	193,616	1,196,060	68,11,44	208,923	7,70,89
,, ,,	1940	20	128,244	1,804,283	85,32,81	608,854	17,19,40
,, ,,	1941	17	105,953	1,642,138	106,73,07	481,849	13,39,75
,, ,,	1942	16	106,686	1,867,148	116,85,27	537,461	12,00,96
,, ,,	1943	16	119,855	2,054,865	140,21,13	556,537	17,24,47
,, ,,	1944 A	5	16,997	115,085	101,91,31	40,323	14,74,04
,, ,,	B	10	117,005	2,359,829	63,29,82	533,621	10,08,05
	Total	15	134,002	2,474,914	165,21,13	573,944	24,82,09
,, ,,	1945 A	6	18,797	128,769	113,41,47	36,108	15,52,20
,, ,,	B	9	134,133	3,607,286	70,32,03	2,311,123	11,29,88
	Total	15	152,930	3,736,055	183,73,50	2,347,231	26,82,08
,, ,,	1946 A	3	6,675	74,124	61,29,70	23,407	7,56,84
,, ,,	B	12	149,447	2,606,034	119,98,76	682,527	24,45,35
	Total	15	156,122	2,680,158	181,28,46	705,934	32,02,19

A.—Banks doing a considerable portion of their business in India, i.e., having 25 per cent. or more of their deposits in India.

B.—Banks which are merely agencies of large banking corporations doing a major portion of their business abroad, i.e. having less than 25 per cent. of their deposits in India.

Note:—1. The wide changes in the summary figures of exchange banks for the years 1945 and 1946 are due to inflation and consequent depreciation of exchange in China affecting the balance sheets of two Chinese banks included in this table.

* Includes figures for Burma up to 1941.

Source: Statistical Tables, 1948, issued by the Reserve Bank.

Exchange Bank's Investments

True to their name as well as origin, these Exchange Banks invest their resources in India, to a great extent, in the purchase of bills drawn against imports and exports to and from India. The financing of our Imports from overseas countries is done mostly by their Branches outside India. The Indian Branches' share in the business consists principally in collecting the amount of the bills at maturity, and in furnishing their other branches with information as to the means and standing of the drawees of the bills. The Indian Branches of these Banks are more immediately concerned with the Export trade, where they have even today, practically a monopoly. In view of the dimensions of that trade, the Banks would under ordinary circumstances require to utilise a very large proportion of their resources in carrying through the business. They are able, however, by a system of a rediscount in London, to limit the employment of their own resources to a comparatively small figure in relation to the business they actually put through. No definite information can be secured as to the extent to which rediscounting in London is carried on; but the figures given on the previous page show a considerable proportion of that business.

The bills against exports are largely drawn at three month's sight, and may either be "clean" or be accompanied by the documents relating to the goods in respect of which they are drawn. Most of them are drawn on well-known firms abroad, or against credits opened by Banks or financial houses in England. Bearing as they do an Exchange Bank endorsement they are steadily taken up by the discount houses and Banks in London. And bills purchased in India are sent home by the first possible Mail so that presuming they are rediscounted as soon as they reach London, the Exchange Banks are able to turn over their investment in about 16 or 17 days instead of three months which would be the case if they were unable to rediscount.

Not all such bills are rediscounted as at times it suits the Banks to hold up the discount rate. They also prefer at times to hold the bills on their own account as an investment until maturity.

The resources in India of these Banks for the purpose of purchasing export bills, are found in a variety of ways, e.g.

1. Proceeds of import bills as they mature.
2. Sale of drafts and telegraphic transfers payable in London and elsewhere out of India.
3. Purchase of telegraphic transfers payable in India by the Reserve Bank.

4. Formerly they used also to import bar gold and silver bullion, as well as sovereigns from London, Egypt or Australia. But in the War these imports are only through the Reserve Bank.

The remaining business transacted by the Banks in India is the usual commercial banking, or short term investments in liquid commercial loans and advances, or discount of local paper through indigenous bankers, shroffs or money lenders.

Joint Stock Banks

Previous to 1906 there were few Indian owned Banks of the modern type operating in this country; and such as were then in existence were of comparatively small importance, with their business confined to a very restricted area. The rapid development of the Indian owned and Indian manned (largely) Joint Stock Bank—which has been so marked a feature in Banking within recent years, really began with the establishment of the Bank of India and the Indian Specie Bank in 1906. In the wave of Swadeshi that swept the country at that time, there was a great boom in new floatations. Many of these new ventures in a somewhat unfamiliar field confined themselves to legitimate banking business. A few, however, were tempted by the prospect of high returns from somewhat risky business, particularly bullion; and so came to grief within a few years after their start. The Banking crisis of 1913 gave a set back which was neutralised by the boom engendered by the War of 1914-1918.

In the interval between the two wars, Indian banking made good progress, as the figures given elsewhere indicate. Confidence has been largely restored, particularly with the prospect of a national Government in independent self-governing India. The failure of the Alliance Bank of Simla and the prompt assistance given by the Imperial Bank, in close association with the Government of India made Indian banking interests perceive the need for a truly national and actively sympathetic Government, if the country's economy was to develop as it should. A banking venture in a wholly new field, viz. to finance long-term investment in, productive industry was tried by the Tatas soon after the end of World War I. But the Tata Industrial Bank, could not continue in face of the apathy or worse of the other banking interests, as well as Government, and so had to be merged with an ordinary Commercial bank of Indian ownership and management.

Statistics given on pp. 56 & 57 show the growth of business and present position of the principal Indian Joint Stock Banks.

TABLE IX

Capital, Reserves, Deposits, Cash Balances and other Particulars Relating to the Principal Indian Joint Stock Banks.

Class A1—Banks having Paid-up Capital and Reserves of Rs. 5 lacs and over—Scheduled Banks (excluding Imperial Bank of India).

(In Thousands of Rupees)

As on	No. of reporting banks	Capital & Reserve Total	Deposits	Cash in Hand and at Banks
1920	25	10,92,48	71,14,64	16,30,70
1930	31	11,90,15	63,25,51	7,67,91
1935**	38	13,19,85	84,44,61	19,12,15
1940	41	12,67,08	106,10,08	25,02,43
1941	44	13,59,90	129,04,39	24,20,66
1942	44	16,25,37	189,33,83	43,76,69
1943	57	23,72,15	324,50,08	74,24,85
1944	69	32,05,78	436,56,86	90,40,15
1945	75	38,77,10	542,80,07	106,22,80
1946	80	44,16,62	624,23,37	120,75,57

** Figures upto 1935 include all Banks with Capital and Reserve of Rs. 5 lakhs and over. Figures since 1936 are for Indian Scheduled Banks only.

Source: Statistical Tables, 1948, issued by the Reserve Bank.

5. Indian Private Bankers and Shroffs

Indian private Bankers and Shroffs have been doing banking business from time immemorial, long before Joint Stock Banks were ever thought of; and they are likely to continue to thrive for some very considerable time to come. So long as the principle of private enterprise in such Public Utility Services is maintained, there is no danger for them. And even when the entire Banking business is nationalised, they will continue to do this work as public servants; and not as private profit-seekers. Their knowledge and experience are too valuable to be lost to the public Service. Only their outlook will have to be readjusted; their motive spring recast; their methods and technique reconditioned. A properly planned national economy must provide work for all citizens who are capable of working, work suited to their training, aptitude and experience; and this part of the nation's business is too crucial to be left to novices.

TABLE X

Demand and Time Liabilities, Cash Balances, Advances and Bills Discounted of Scheduled Banks including Exchange Banks as shown by their weekly returns as on the last Friday of each year.*

(In Lakhs of Rupees).

Year.	No. of Reporting Banks.	Demand Liabilities.	Time Liabilities.	Total Demand & Time Liabilities.	Cash in hand & balances with R.B.I.	Percentage of Cash balances to demand & time liabilities.	Advances.	Bills discounted.	Percentage of Advances & Bills discounted to total demand and time liabilities.	Total number of offices including branches, pay offices, etc. in India.
1935	49	121,93	98,67	220,60	35,88	16.26	83,31	3,52	39.36	723
1940	62	174,94	100,76	275.70	57,08	20.70	1,01.45	2.40	37.67	1,351
1941	62	224,73	112,79	337,52	41,70	12.35	1,22,57	6,35	38.19	1,454
1942	61*	335,06	114,04	446,10	63.89	14.32	95.37	2.97	22.04	1,450
1943	74*	500,82	157,28	658,10	116,21	17.56	1,60,86	6,74	25.47	1,882
1944	84*	616,09	202,92	819,01	106,07	12.95	235,80	13,41	30.43	2,443
1945	91*	672.57	280,26	952.83	120,83	12.68	302,89	24,30	34.34	2,947
1946	96*	730,16	330,95	1,061,11	117,28	11.05	442,31	22.88	43.84	3,519

Number of Offices including branches, pay offices, etc. in India (1946).

I. Scheduled Banks.	
i. Imperial Bank of India	443
ii. Exchange Banks	77
iii. Other Scheduled Banks	2,949
2. Non-Scheduled Banks.	
i. Banks having paid-up capital and reserves of Rs. 1 lakh and over	2,194
ii. Banks having paid-up Capital and Reserves of Rs. 50,000 and Rs. 1 lakh ..	494
iii. Banks with Paid-up capital and reserves below Rs. 50,000	553
3. Co-operative Banks.	
i. Banks having paid-up capital and reserves of Rs. 5 lakhs and over ..	207
ii. Banks having paid up capital between Rs. 1 lakh and Rs. 5 lakhs ..	372

* Burma Scheduled Banks excluded.

Source:—Statistical Tables relating to Banks in India 1946.

The term "Shroff" derived from the Arabic sharif—a good person of good standing—is used, in this connection, nowadays for a person who charges usurious rates of interest to impecunious people or a mere usurious moneylender. This is, however, hardly fair to the people known as "shroffs" in banking language as the latter are of very real service to the business community. They serve as feeders to the Joint Stock or Exchange Banks in India, as they are in direct touch with the producer. Under present condition the Banks in India can never hope to be able to get into sufficiently close touch with the real primary producer, the country shopkeeper, who handles the bulk of the internal trade in India to enable them to grant accommodation to more than a fraction of these traders direct; and it is in his capacity as middleman that the "Shroff" proves of such great service. In the same way he brings a very considerable volume of business within the scope of the Imperial Bank and enables the latter to give accommodation, which, without his assistance, that Bank and the Scheduled Banks would not be permitted to give. The modus operandi for a shroff as an intermediary between the trading community and the Banks arises as follows. A shopkeeper in the bazaar,with limited means of his own, finds that, after using all his own money, he still requires say Rs. 25,000 to stock his shop adequately. He thereupon approaches the "shroff", and the latter, after very careful inquiries as to the shopkeeper's standing, grants the accommodation, if he is satisfied that the business is safe. The business, as a rule, is arranged through a **hoondee** broker, and in the case referred to the latter may probably approach about ten shroffs and secure accommodation from them to the extent of Rs. 2,500 each. A **hoondee** which is our version of a Bill of Exchange, usually drawn at a currency of about 2 months, is almost invariably taken by the shroffs in respect of such advances.

In this the Shroff primarily invests his own capital, if the business coming to him in this way is much larger than his own resources can cope with, he seeks assistance from his Bank. A number of the bills held by him are taken to the Bank for discount, under his own endorsement; and the Bank accepts such bills freely as they are doubly secured. The extent to which the Bills of a Shroff would be discounted by the Bank is determined by the standing of the shroff and the strength of the drawers. The extent to which any one Shroff may grant accommodation in the bazaar is, therefore, dependent on two factors, viz:—

1. the limit which he himself may think it advisable to place on his transactions; and

2. the extent to which the Banks are prepared to discount bills bearing his endorsement.

The Shroffs keep in very close touch with all the traders to whom they grant accommodation, and past experience has shown that the class of business above referred to is one of the safest the Banks can engage in.

The rates charged by a Shroff are usually based on the rates at which he in turn can discount the bills with the Banks. They necessarily vary according to the standing of the borrower and with the season of the year. Generally speaking, however, a charge of two annas per cent, per mensem above the Bank's rate of discount, or 1½% is a fair average rate charged in Bombay to a first class borrower. Rates in Calcutta and Madras are on a slightly higher scale than in Bombay due in a great measure to the fact that the competition among the Marwari and Multani Shroffs for business is not so keen in these places as it is in Bombay.

The resources of these indigenous bankers are mainly their own capital; but they also receive deposits whose volume, however, is not known. So far they have not been subject to any legislative regulation of their business. So long, however, as they confine themselves to their traditional work, and keep away from speculation on the stock, bullion, cotton, or commodities exchanges, they are safe, and earn a fair living. But once the virus of easy money, or unearned income enters their veins, and that seems almost unavoidable in these great haunts of modern business in India—the safety of their business, their credit and security inevitably suffer. If, and when, therefore, banking comes to be regulated and controlled, as a great public utility service, and as integral part of a planned national economy, these individualist, indigenous bankers cannot be suffered to remain untouched, and frustrate by their individualist operations the success of the Plan.

6. Co-operative Credit Societies

The Co-operative Credit Societies, which do banking business mainly in connection with Agriculturists; and the Land Mortgage Banks, which seek to assist land-holders or tenant-cultivators to develop their holdings, have been considered in other volumes in this Series dealing with Crop Planning, Land Policy, Rural Marketing. It is unnecessary, therefore, to cover the same ground over again. We must point out, however, that these institutions keep severely to the initial purpose of dealing with relatively small producers. They are unable to assist them into transforming Agriculture, or Land

cultivation into modern, large-scale, mechanised Industry; and so fail to aid actively in the most important sector of our National Economy. Their methods of business are mechanical; their outlook necessarily restricted; their field of operations rigidly limited. They will have to be much more expansive and liberalised, and knitted together more closely with the rest of the Banking organisation of the country, if they are to do any real service in the cause of planned economic development of the country.

7. Land Mortgage Banks

Essentially the same criticism applies to the Land Mortgage Banks. It must be added, however, that the restricted nature of their work is not of their own doing. The laws relating to land tenure, and the social system in general affecting immovable property, make active development by these institutions, as in a largescale industry, all but impossible.

8. Industrial Finance

In the Volume dealing with Industrial Finance, some space has been devoted to the recently established Industrial Finance Corporation, and the place of such Institutions in the progressive development of the National Economy; and so no more need be said on that head in this place. Similarly, also, the work and shortcomings of the Post Office Savings Banks have been reviewed in that volume. It is needless, therefore, to repeat ourselves.

VIII. Review of Banking Business in India

Having reviewed the principal types of Banks and Banking business in this country, we may now sum up their chief characteristics or shortcomings.

1. Practically all the banking business in this country today is of the orthodox commercial type, familiar chiefly in Britain. Our Banks have no concern, directly, with the all-round economic development of the country, its productive capacity or distributive justice.

There are, no doubt, special types of Banks, like the Co-operative Credit Societies, and Land Mortgage Banks, which are concerned with financing Agriculture. The Industrial Finance Corporation, recently established, is expected similarly to minister to large and small industry. But all these are restricted in their operations, both as regards the actual field open to them, and the nature of business they are permitted or accustomed to do.

So long as the country's industrial or agricultural productive capacity remains thus unaided by new capital, or fresh impulse provided by new investment, the progressive development of our productive resources, and ensuring of better distribution, would be impossible.

In a planned economy, therefore, it is of the utmost importance that Banking should be varied, and should meet all the requirements of every sector of the country's economy, in production as well as distribution, for Government as well as for the people at large. It is not necessary, nor even wise, that each bank should do all kinds of banking business. But there must be appropriate institutions for the different types of banking business; and they should all be co-ordinated at the apex.

Without minimising the importance of trade, both domestic and foreign, and the need to finance it adequately and appropriately, it may yet be pointed out that so long as our National Economy remains on the basis of **Production for Exchange** and not **Production for Use,** Finance Capital would have a disproportionate importance; and Banking of the type reviewed above will almost entirely monopolise this essential Public Utility and Social Service. Banking concerned with trade finance is, no doubt, a service; but it is not productive in the sense that financing Industry or Agriculture would be.

2. That Banking is a Public Utility and a Social Service, which, though not directly productive, can be an essential aid in producing new wealth, and so improving the general standard of living, seems scarcely realised in this country. The place of Banking, therefore, in the scheme of active development of the National Economy of a country like this is scarcely appreciated. Those, therefore, who have the carrying out of a planned programme of development in their hands will have not only to see to it that Banking as a whole, in all its varied forms and functions, is adopted as a truly national concern operating mainly for developing the country's productive capacity and ensuring better distribution, most effectively as a socialised organisation; but they must also adapt the several types to the different kinds of business or service required from Banks.

Even if the wholesale Nationalisation of all Banks and the entire field of banking business is, for any reason, deferred, the socialised Reserve Bank of India and the soon-to-be socialised Imperial Bank, working from the top must so conduct their operations, and so control and regulate the other Banks working along with them in the several fields of the

country's commerce, industry, and agriculture, mining and forestry, as to keep all the various sectors in line, and make all of them contribute to the same end.

3. Because of this leading feature of banking in India operating mainly as commercial financing institutions, the facilities and service Banks have evolved or are accustomed to perform, are necessarily of a corresponding character.

The supplementing that Banks are expected and accustomed to render in other countries to the currency system of the country by Deposit Currency, or Cheque Money, is confined to a very small section of the community, as the Clearing House Statistics, given in the review, show. There is no direct link, functioning automatically, between the Currency and Credit systems of the country. The volume of Currency in circulation is practically impossible to expand or contract in accordance with the varying needs of business simply because of this lacuna. A properly planned national economy must forge such a link at the earliest opportunity, particularly if the price mechanism is to function as an integral part of the National Plan.

4. Thanks to their origin and development as commerce financing bodies, Banks have not developed Forms or Instruments of Credit, which could help to minimise the use of metallic money, and the reserve needed against Paper Currency. There is no means to mop up and utilise the surplus of production over consumption as soon as it is formed. Such devices as the **Postal Cheque** or the **Giro System**, which before the War were quite common on the Continent of Europe, are unknown. Even Traveller's Cheques and Letters of Credit operate in a very limited field, and mostly by Non-Indian Banking interests.

Land Mortgage Debentures or Industrial Bonds, payable to bearer, or transferable with the least difficulty, which could bring fresh blood from time to time in the body economic, are equally untried.

As explained in the Volume in this Series dealing with Industrial Finance, the history of the various types of Savings, including those in the Post Office Savings Bank, shows large room for further expansion, which is yet undeveloped by Banks or Government. The mobilisation, therefore, of the surplus of production over consumption in the country, such as it may be, and its prompt utilisation for further development of the country's productive capacity are utterly unplanned. If they exist at all, they do so merely as an accident,

not as a matter of set purpose or an item in the planned programme.

5. There are not sufficient Banks to meet the needs of such a large country and its vast population. Statistics given earlier in this section, show the total number of all kinds of banks and their branches to average, for every 50,000 of population. This is comparatively very poor, and will need to be much more expanded, so as to have a bank, or a branch office,—working along with the Post Office, for example, to economise in staff, buildings, etc., for every 1,000 of population.

The question whether the future development of banking in India should take place on the British, or on the American, model, will have to be immediately tackled by the Planning Authority when it comes into being.

The former concentrates banking power, wealth, and influence in a few large banks, each with a net-work of branches spread all over the country, and numbering hundreds. The entire country is covered, every section of the community served by this arrangement. The whole enterprise is however, directed and controlled from one centre. The smaller or country-banker, who knows the local clientele and understands local needs, tends to disappear in this arrangement. Local needs likewise, of particular industries, agriculture, or trade, also tend to be subordinated to the requirements of the few central places, or even one business centre, like the city of London.

In the latter or decentralised system of banking, as it prevailed in America, each state, city, or township, not to mention still smaller units tends to have its own bank, manned and operated by those familiar with the local economy. The tendency to centralisation has, no doubt, manifested itself in the United States, also. Since World War I the United States banker has begun to pay attention to Foreign Trade Finance, or international banking. But the basic tendency still remains there towards decentralised banking.

In India banking, seems to have hitherto developed on the British model, with a few powerful banks, with large resources, having their head-offices in capital cities, and a growing net-work of branches in all likely centres of commerce, who take up the bulk of the country's banking business. There is in this tendency a danger of lop-sided development, which the Bill now before the Indian Legislature apparently seeks to check. As the Bill stands, however, this check would operate more on new banks coming into being hereafter, than

on those existing in 1948. If the potentialities of this country are taken into account, the past ought to be no guide or model in such matters. Banking must be reorganised almost from the roots upwards. Its form and structure, technique and function must be entirely recast, so as to fit in smoothly with the over-all Plan as and when it comes into being.

6. Banking in India is still to a very considerable extent dominated by Non-Indians. They have evolved the pattern and set the model. The Constitution of the Central Government until August 15, 1947, and such Legislation as relates to Banking in general, have combined to keep these alien vested interests intact. The result is that India's productive capacity meets with an invisible handicap, which needlessly restricts its potential strength.

Legislation now impending for consolidating the law relating to Banks and Banking in India, maintains the same attitude. Any planned programme of national development, however, must reckon with this feature of India's present Banking Organisation, recognise its obstructive or restrictive reaction upon our productive needs, and deal with it so as to make this great Social Service operate in the true interests of the country only, add to its productive organisation, and help secure better and more equitable distribution.

If these suggestions are adopted, Banking will not cease to be as varied in character as it is today. Probably the variety in types of institutions as well as kinds of business done by them, would be much greater, in a properly planned national economy expanding and co-ordinating all activities. But there will have to be a close co-ordination, not only as between the various types of Banks and their business, but also as between Banking and all other Utilities, Services and activities in Industry, Commerce, and Agriculture, so that the capital requirements of every sector may be furnished as easily and effectively,—without excess or deficiency,—as may be necessary.

There is no co-ordinating link in the various types of Banks, functioning in the land, and the several kinds of business they do. The Reserve Bank, now nationalised, is a Central Bank for this country, in charge of its monetary organisation and credit control. Its commercial adjunct, the Imperial Bank of India, is another apex of the pyramid. On the other Banks, there is neither co-ordination nor control, neither regulation nor supervision from some central focal point, to make them all march in step to the prescribed, predetermined goal. This must be provided if Banking is to be

a real service, a great public utility, and an integral part of the National Plan.

IX. Credit System of the Country

While reviewing the Currency and Banking Systems, note has already been taken of the working of the Credit System. Credit is, essentially, anticipation of future wealth, for producing which finance is needed by the producer to meet the expenses of production. It is not wealth actually in existence, it is wealth to be produced as represented by the accommodation sought.

Credit is thus based on the judgment of those who dispense available resources from past savings regarding the capacity of the entrepreneur. It may be done for the individual as for the nation as a whole from indigenous resources or those borrowed from abroad. This is done usually by banks operating at the point where the producer disposes of his production to the consumer through the instrumentality of merchants or other middlemen. It could also be done more directly at the point where the process of production begins, by financing operations, whether in Industry, Agriculture, Commerce, or any form of new production, service, or utility. In the existing social order all over the world outside Russia, a whole host of middlemen are interposed between the primary producer and the elements that own or can dispose of investable surplus of past savings; and they have to be fed. That adds to the cost of production, involves waste or mal-utilisation of the available resources, and neglect of potentialities of new wealth which are either not understood or not favoured by these owners or disponents of the investable surplus. For a country intent upon wholesale planning this needs to be radically remoulded.

From this point of view, in several respects the Currency and Banking System of this country, on which depend the development and functioning of the Credit machinery, is defective. Under planned economy, however, the role of Credit in facilitating the production of new wealth by anticipation would become more important. The anticipation of new wealth would be facilitated automatically, specially if that machinery as well as the means of distribution are socialised. So long, however, as all the Public Utilities, Social Services, and productive activities are not socialised, and private enterprise with its motive spring of private profit remains, there will always be the risk of the institutions dispensing credit and the instruments embodying it being abused or misdirected.

There may consequently be, at times, an excess of wealth anticipated, or a needless deficiency of such anticipation. Economic crises, or the evils of inflation and unnecessary stringency happen without any co-relation between the potential productive resources of the country, and the means to develop them and produce new wealth. It is of the utmost importance, therefore, that all the instruments as well as institutions concerned with Credit, its forms and applications, should be carefully recast and co-related so as to be assigned their proper place and function in the over-all National Plan.

X. Regulation and Control of Foreign Exchange

In the economic structure before 1914, all Foreign Exchanges were automatically regulated by the functioning of the orthodox Gold Standard, which was the prevailing basis of Currency in the leading commercial countries of the world. It was assumed as an axiom that all ratios in Exchange of the several currencies entering into international trade would be adjusted and all balances settled by the movement of gold to or from given countries which showed, in the aggregate of all the items entering into the balance, an excess of dues from them over the amounts receivable from them exported gold to settle the adverse balance; and **'vice versa'**. The most considerable items in this balance are the imports and exports of merchandise; the former constituting the debits against the country importing, and the latter the credits of the country exporting. But these are not all. There may be a number of "invisible" imports or exports which may swell the balance for or against the country concerned. Trade between nations not being always the exchange of natural surplus or speciality in commodities, and international accounts being complicated by a number of humanly controllable factors, the management of the Foreign Exchanges of a country became a great temptation to the Banking Authorities or the Government of a country. It was also believed that a high ratio depressed the country's own industry, while a low ratio encouraged it, which was an additional temptation. The regulation and control of Foreign Exchanges thus came to demand the exercise of supreme authority of a country even in normal times; while during the War such control became inevitable.

World War I had distributed the assumption of an automatic regulation of Foreign Exchange. The leading currencies of the world had materially depreciated. Though efforts were made after that struggle to return to the orthodox arrangement and working Gold Standard by the principal commercial countries of the world, they had to be soon abandoned because

of the unreality of the assumptions on which they were based and could succeed. Managed currency and controlled and regulated Exchange had become the order of the day for almost every country, even before the World Depression of the early thirties during which even the richest nation of the world,—the United States,—had to abandon its old Gold Standard, artificially depreciate its exchange ratio, and introduce an element of managed exchange, which, however, is still the nearest to the pre-war foreign exchange adjustment.

Britain tried in 1925 to regain her old Gold Standard and fixed exchange; but within six years of its restoration, the so-called bullion standard had to be abandoned by her. The dollar sterling ratio was fluctuating all through the thirties. With the help of America, moreover, Britain has been able all through the war years to maintain a fixed ratio of dollar-sterling exchange, pegged at a little over $4 = £1. But the realities of her economic position make it impossible for her to maintain the pound even at its present highly depreciated rate of exchange with the dollar. Other currencies have almost all depreciated very seriously and so the maintenance of artificial exchange ratios becomes a normal function of the banking authorities in any country.

In India the Ratio in Exchange has been artificial, ever since the Mints were closed to the free coinage of the silver rupee in 1893. The artificial ratio has been fixed primarily in relation to sterling, which at the time was assumed to be as good as gold; but which since has very substantially depreciated after the dislinking of the pound sterling from gold. The perversion or distortion of the provisions regarding the purchase or sale of gold,—or now sterling—by Government or the Reserve Bank has given rise to the most complicated post-war problem in Indian Finance, namely, the liquidation of the so-called Sterling Balances. For the last 50 odd years, the Rupee has been a managed currency; and the maintenance of its ratio in exchange not the least of the headaches of the Government or the authorities concerned.

In the section of this volume dealing with the Summary of Developments after the Interim Report of this Sub-Committee was presented, an attempt is made briefly to outline the latest form of Exchange Control as it has been operating in recent years. Old factors have changed and several new ones have entered to complicate the situation. India's sterling debt, for which payments had to be made by exports of goods from here, has disappeared or been repatriated. Other items in the old "Home Charges" have also been eliminated since

the attainment of independence. These have reduced the need for a steady and substantial excess of exports over imports of merchandise which used to be the outstanding feature of our Foreign Trade for all these centuries. On the other hand, India has become a deficit country in the matter of our food supply, and so needs to import grain on a very large scale at very high prices. Her ambition towards progressive industrialisation and planned economy has emphasised the need for importing capital goods, the payment for which is increasingly difficult to make because of the objective to use up all raw materials within the country itself, and even to import some special qualities. During the War, this new development did not manifest itself, as the heavy stream of war supplies to the allies more than wiped off the converse stream. But with the end of the War, the new features have become more and more prominent; and the regulation of our Foreign Exchanges more and more complicated.

It is enough to add here that whatever the origin of this machinery of control and regulation of Foreign Exchanges, it is necessary, and can be made advantageous if it is worked as an integral part of a complete economy. The regulation, needless to add, will have to be with reference not to sterling, but rather to the most stable international medium of exchange, viz: the dollar, which means eventually gold. The statutory link of the rupee with sterling has been already scrapped. And though the Rupee is not yet wholly an independent standard of money, the new orientation in India's foreign trade, must make her think more and more of her exchange ratio with other currencies as well. The controversy about **Stability of Exchanges** vs. **Stability of Prices** is at bottom the same problem; and we in this country have to secure both, while our planned economy is in process of being formed. Ad hoc unco-ordinated control of exchanges is as injurious as such control in any other departments. It is the essence of Planning that there must be strict control in all facets and sectors of the Plan; and it is the essence of such control that it must be both thorough and universal. Exchange control is perhaps the most crucial form, and must, therefore, be considered as an unavoidable part of National Planning so long, at any rate, as foreign trade remains an important adjunct of the working of the national economy, and creates a likely loophole for upsetting or frustrating the Plan through extraneous factors.

Regulation of Metallic and Other Reserves and Mobilisation of Capital Resources

Apart from those already made while discussing the country, no remarks are necessary on these items in the Terms of Reference to this Sub-Committee. If more elucidation is desired, the reader is referred to the Volume on "**Industrial Finance**" in this Series, which deals with the subject of Capital Mobilisation more exhaustively, as also the Promotion of Saving and Investment habits. The Measures necessary for Linking up Rural Credit with the Capital Market are likewise indicated in that and other Volumes dealing with Crop Planning and Rural Marketing and Finance.

K. T. SHAH.

REPORT OF THE CURRENCY AND BANKING

SECTION I

1. The conclusions given here are the briefest summary of highly technical points, and nearly each one of them would have to be elaborated with details, many of which have a bearing, one on the other. Finance cannot be considered by itself in one aspect, and we must record that we had no opportunity of knowing what has happened with regard to Public Finance, Rural Finance, Industrial Finance and other Sub-Committees, whose conclusions might lead to modification in our conclusions or vice versa.

2. It will be further noted that there are no quantitative estimates of requirements of credit or of money. We have gone on the basis that such requirements will be large, but, just as we would be influenced by a statement of these requirements, we in our turn would have asked the National Planning Committee to hold their hand to cut down those requirements to finances available.* This essential interaction is absent in our conclusions, which therefore only affect the structure of banking and currency. But mere structure is secondary, the actual working of the Banking and Currency system must depend on the strain put upon them and if progress was required free from financial crises or breakdown quantities are even more relevant to our work than mere outline of structure. We have made this preliminary report solely in response to the urgent plea of the Chairman's circular letter, but we must utter an emphatic warning that it would be unwise for the National Planning Committee to proceed, without further and fuller report, to the construction of a plan that would break down on the financial side before it had made any appreciable progress.

3. The task before the sub-committee is in the main two-fold. Taking the Banking section first, it is to see how Banking service in India could be extended in volume, and improved in quality, and made cheaper so as to be within the reach of many more than those who are at present served by banks, and also how the Indian money market could be strengthened in structure and otherwise. Credit which can play a very important role has been crippled in India through the breakdown of the indigenous system as it existed during

*Prof Shah pointed out that this matter for estimating the requirements was in the Province of another Sub-Committee.

the last 200 years, and in its place, new institutions or individuals who would serve the community have not been replaced. Some of the measures suggested by us are calculated to secure marked improvement during the next decade in this direction.

4. The position of the Reserve Bank of India as the Central Banking Authority with wide powers—with powers which would be still wider when further regulations are introduced—naturally needs to be altered from the present very unsatisfactory manner in which that institution is functioning, being an unwitting instrument for policies which are injurious to India. The Reserve Bank is not only wholly dominated by Government, but is carrying out policies shaped by the Bank of England and dictated from London. The Indian Directors must be presumed to have failed to show initiative or power for withstanding such policies in India's interests. We therefore suggest immediate nationalisation of that Institution.

5. Banking business of every description must be carried on under a licence, and must be subject to such regulation, supervision and general control as the Central Banking Authority imposes from time to time.

6. As one of the essential conditions of the licence to do banking business in this country, it will be insisted that at least 95% of the personnel will be Indian. In the case of banks registered in this country we see no reason why all directors should not be Indians, the employment of any foreigner in any bank being left open as expert adviser only, and not as chief executive or manager.

7. The phenomenon of banks not registered in India receiving deposits at very low rates, and making this money available to foreign commerce and industry, in competition with Indian enterprise, needs careful examination. One method of dealing with the situation would be to impose a charge of one per cent. on all fixed deposits in banks earning a low rate of interest. We however prefer the other method, as suggested in the Minority Report of the Indian Central Banking Committee, namely to prohibit banks not registered in India from receiving any deposit or raising loans, in the same manner as in the United States of America.

8. Banking service through branches of Joint Sotck or other banks exists in India only to the extent of one banking office for about two and a half lakhs of population, as against one such office for five thousand persons in the United Kingdom. We do not think that this state of affairs can serve the needs of Indian trade and industry satisfactorily, especially

under Planned Economy. We think there is scope for increase of branches of large Joint Stock Banks as well as for smaller banks each of which may confine itself to a locality, where it can have better knowledge of local needs and conditions. But the multiplicity of very small institutions, such as those in Bengal and Travancore, unregulated and unassisted, should be avoided. The indigenous banker, who is increasingly withdrawing capital from banking business, must be reinstated, but in a modern setting, with a certain amount of regulation, in consideration of which he will receive a measure of assistance and recognition. Land and its produce, gold and silver ornaments and other securities, hitherto accepted against advances could be fully restored to their original position in this respect as basis of credit through an all embracing scheme, details of which lack of time prevents us from giving at the present stage.

9. The cheque as an instrument of credit has to some extent undermined the position of hundies; but the hundi system must be revived and reinforced in order to provide an appropriate instrument for short term credit and a suitable investment for commercial banks. Institutions specialised in dealing with hundies and known as Discount Houses, must be brought into existence at once at the principal centres in India, with such special facilities as are considered necessary to enable them to operate on a scale large enough to cover all charges.

10. The work of the Post Office Savings Banks should be enlarged so as to provide the poor man with the same banking facility whether of drawing cheques and transferring funds from one branch to the other, or by any other device like the Giro system.

11. The Postal Savings Bank and Co-operative Credit Societies must provide similar facilities wherever possible on the same terms to their depositors so as to cover all citizens as to remittance.

12. All remittance charges, (not telegraphic), within India should be eliminated by the Reserve Bank permitting Member Banks to draw at one centre and pay at any other centre where the Reserve Bank has a branch or an agent. The Member Banks should allow the same facilities to their clients, subject to a minimum unavoidable charge, the schedule of such charges being approved by the Reserve Bank; and where they have no branch of their own they must make arrangements with agents to provide the same facilities to their clients.

13. The Stock Exchanges should be reorganised, and should work under very strict public control, with a non-official Chairman appointed by Government. Their rules should be scrutinised with reference to the periodical crisis including the technical causes that arise; and revised so as to prevent or minimise such crises.

14. The rules of business of the Stock Exchange must, likewise be revised so as to prevent, or at least keep under rigid control, excessive speculation and cornering, which frighten away or damage genuine investors. Every effort should be made to provide all necessary information through the Stock Exchange so as to help intending investors in their search for safe and productive investment. The Stock Exchange should function so as to promote such investment.

15. We think there is a market in India for bonds, which has not been developed adequately, but it would be wrong to put on this market an undue strain by an excessive supply of Government bonds for all and sundry purposes. We deprecate the system of Government guarantees to private enterprise, which would fritter away public credit without public control. We cannot but utter a word of caution against the scheme of wholesale purchases of zamindaris by issue of bonds or the creation of bonds **ad lib.** for land mortgage banks.* Bonds which are issued must be as a rule of a self liquidating character from the produce or income of the assets against which they are issued and not from the resale of assets as such. We think it absolutely essential that the supply of such bonds from all sources on the market should as a rule be slightly less, instead of slightly more, than the demand. Excessive public debt transferring the burden to the future, must be avoided and the rate of public borrowing could be kept down, if the restraint referred to above were kept in mind. All this has a direct bearing on the amount of deposits, which the banks could receive, as both the money for short-period and long-period bonds, as well as for short-period and long period deposits, come out of the loanable capital available at the moment.

16. All commodity markets, in which future or forward dealings take place, must be under regulations, approved by the State. The State must have the authority, as and when it considers it necessary to put an official on the Board, or an official Chairman of every such commodity exchange. The

*In the opinion of Prof. Shah, bonds issued on the security of Zamindari rights taken over by the State can under certain safeguards be made self-liquidating.

Rules regarding prevention or minimising of speculation mentioned above in paragraph 14 should also apply here, **mutatis mutandi.**

17. The present anarchical condition in the foreign trade of India should be ended. That trade, both as to imports and exports, must be so conducted as to eliminate the competition of Indians with Indians. Increasing use must be made of recognised corporations, especially charged with functions of exporting Indian produce abroad to different countries. In the matter of imports the same rigidity need not be followed, but every effort should be made to secure collective purchases abroad so as to eliminate waste in order to be certain as to quality through inspection, to prevent some isolated Indian buyers being victimised as to prices.

18. All import and export trade must be done under a system of licenses, which should be freely given; but which are so designed as to enable the State to have the fullest information regarding the direction of the trade and to facilitate control and regulation as they are found necessary.

19. This control would be exercised with several objects in view such as guaranteeing the reputation of Indian exports for quality in foreign markets; regulating the direction of the trade, so as to maintain the requisite flow of trade stream in the direction required by a trade treaty if any, and evenly throughout the year as far as possible, keep up the total value of a particular trade, eliminate needless competition between Indians, as and when necessary, in the foreign market, pooling of resources, or costs for dealings abroad, so far as the export trade is concerned. For the import trade, restrictions would be with a view to prevent the entry of commodities, which are deleterious to the health and morals of the people, or which are dumped on this country, or which compete unfairly, or to an excessive degree with articles of local production.

20. The entire Foreign Exchange business of the country should be, conducted through the Reserve Bank.* The Reserve Bank should make Foreign Exchange available to the other banks within limits of safety for the external value of the Indian currency.

21. We think that there is still an unnecessary and heavy drain of funds from the Indian money market in respect of premium payments made to foreign companies doing both life and other forms of insurance in India. Some of the evils from the growth of mushroom companies in connection with Indian

*Prof. Shah is of the opinion that it should be monopolised by the Reserve Bank.

insurance enterprise have been brought under check by the new law, and we think that it is capable of further expansion so as to cover the bulk of such Indian business as there is at present and what might grow in future, as the insurance habit increases. This means of enriching the Indian money market by the retention of these funds in India is one, which we must definitely advocate. Having regard to the needs of the state in an all-embracing plan, we would suggest for serious consideration the extension of the state insurance scheme at present in use by state employees only to the public with a view to eliminate private enterprise in this field (subject to suitable compensation to existing Indian companies). This will, in our opinion, not only permit of the retention of some funds at present leaving the country in India, but of its direct use by the State for purposes, which are essential and which call for larger immediate financial resources, with an absolute ultimate guarantee of payment when the claims arise.

Section II

22. In regard to the Currency portion of our Reference the object should be to see that the Indian currency rests on a basis beneficial to India and is in a form convenient and acceptable to the people. The standard of currency for internal purposes must be stable and safe. The Indian money should have abroad a reputation for soundness and strength; and should be proof against all attacks of speculators or foreign enemies and others.

23. The value of the Indian Currency Unit, whether at home or abroad, should be regulated exclusively by considerations of benefit to the Indian national economy, and not in the ruinous manner as at present, when the Rupee is linked to the Sterling. The linking of the Rupee with the Pound Sterling should not be continued longer than is absolutely necessary, and the link should be broken as early as possible on the reporting of the central banking authority of the country, that they have adequate resources to deal with the situation, which will arise thereafter. The Exchange Control, recommended in sections 18, 19 and 20 is calculated to enable the Central Banking Authority to do this without any difficulty after a year or two at most.

24. The periodical depressions arising from changes in the purchasing power of money should be minimised by the maintenance of several Index Numbers in the States based on different commodities and different considerations but indicating to the Central Monetary Authority in the country, viz. the Reserve Bank, the directions in which fluctuations in the purchasing power are taking place. This authority should try by different methods at its command through the various regulations including the regulation of the volume of currency outstanding to prevent sudden or prolonged fluctuations affecting the primary producer.

25. No reserves against the Indian Paper Currency, or the Indian Credit and Banking System, should be in Sterling, as hitherto. All such Reserves should be normally in India but the Reserve Bank should have discretion and powers of holding a portion at such places abroad (in gold only in quantities laid down by law) as is considered desirable and necessary, Reserve in gold should not be permitted normally to be kept out of India.

26. No other immediate changes in the currency system of the country are recommended. Every attempt should be made to see that the value of the different denominations of coins or notes, inter se, inside the country is maintained without discount. Sufficient currency of different forms and denominations should be issued according to public demand.

27. The export of gold from India on private account must be prohibited forthwith, and the import of gold must be confined to the Reserve Bank only. The Reserve Bank must import gold in such quantities as may be estimated to correspond to the demand for it for private use, and must have a statutory obligation to sell it to the public at a price to be fixed from time to time as a normal practice.

28. For purposes of national economy, the whole of the national wealth can be used, as the basis of credit, and may be used for many more purposes than hitherto. The credit structure has hitherto been based entirely on private initiative, with the result that much capital, which could have been itself used, has been lying idle, much cash is circulating at a low velocity and a much larger credit structure for financing increased operations in volume, which a careful planning of the wealth of the country could have secured, has not been secured in the past. Efforts towards this end should be made through the central banking authority. Large inducements should be held out to all, who have got resources not immediately spent or intended to be spent, to make these resources available to the banking system of the country for larger national use. Where inducements do not prove adequate, a measure of mild compulsion will have to be devised. It is too early and too premature to formulate such measures. Credit has to be created when the use, to which it is going to be put, is already there and has matured. Any earlier paper programme might actually do a lot of damage by shaking confidence.

29. In not recommending any immediate major changes in the monetary system of the country, the principal ground, which has deterred us, has been the desire to keep off cheap expedients and short cuts (being the convenient use of the printing press in one of its numerous forms) which will immediately raise the resources, only to cripple them after a short time. It is easy to generate speed in a vehicle, but not so easy to invent the necessary brakes, which will be effective and which could be applied as and when it is desirable to do so. Financial breakdown brings in its wake a complete paralysis of the economic machine, and it is the poor who always

suffer more from the result of such breakdowns coming through unwise experimentation with the medium of exchange.

30. The weakness of the primary producer with regard to his holding power for commodities leads him to sell off his produce at low prices and at a moment when there are other sellers competing. This is entirely unnecessary. It looks natural, because that has been the order of things in the past. In a well Planned Economy, it should be possible for the primary producer to hold out as long as he likes. This will mean the sale of produce, not all at once, but in small chunks or doses. It will enable the primary producer to get better prices. It would weaken correspondingly the strength of the middlemen and the distributors. Towards this end, it is recommended that warehousing facilities should be created, at as many centres as practicable in which the commodities will be placed on safe deposit, and the state will issue a warehouse receipt. If it is at all possible, the charges in connection with these warehouses should be eliminated and borne by general revenue. If that cannot be done, they should be kept down as low as possible. Simultaneously, the expansion of credit contemplated in other parts of this report must enable parties holding werehouse receipts to raise moneys on these receipts freely to the extent of almost, but not, the whole value of the produce. It is wellknown, by experiments elsewhere in the world, that the market will seldom fall below the rate of advance, which the State has fixed. In fixing a fairly high rate of advance, of the total value, the risk, which the State will take, would be relatively small and even where, after due notice to the party, who has taken the advance, or on his default the produce is sold off, neither the State nor the producer would stand to lose anything appreciable. A greater amount of carry-over would be then possible, but not at ruinous rates, both as to interest and charges and as to middlemen's profit, as at present.

31. We do not suggest that there should be any general scheme of price control either in the wholesale or in the retail markets. In section 24, a suggestion is made for the Central Banking Authority to maintain index numbers fashioned in different ways and in public interests to so adjust the machinery of currency and credit as to prevent widespread or extensive fluctuations. In other words, a general stability should be aimed at in the wholesale market, which will be good for the producers and which will destroy opportunities for the creation of speculative gains and other unduly large profits to merchants and distributors. With regard to retail prices, there is a racket, from which the poor are suffering in

India both as to quality, weights and measures and to the price charged. In order to eliminate this evil, or to reduce it to the smallest proportions, it is recommended that all retail dealers must exhibit in bold characters the price, which they propose to charge. In other words, all shops must be compelled to have fixed prices. A recommendation with regard to weights and measures is emanating from the Manufacturing Industries Sub-Committee, and must be strictly enforced, and endeavour should be made to see whether the retail price of an article could have some basic relation with the wholesale price of that article, so as to put a limit to the charges which the middleman can make. But, in view of the extreme generality of articles, and of different local conditions prevailing in different places, particularly with regard to rents, salaries and other charges, it is difficult to indicate a definite scheme of universal application, but power should be taken by the State to check profiteering, and any serious cases thereof, which come to the notice of the State, should be dealt with. In other words, the interests of the consuming public must be safeguarded.

32. Consumers' Associations are donig useful work in other countries, as providing a central ground, where information with regard to unfair treatment by retail merchants is pooled and spread out amongst the members. The establishment of such associations in all urban centres is recommended with a view to enable a body of public spirited men to collect the necessary information and to bring it to the notice of the controlling authority for suitable action.

MINUTE OF DISSENT OF PROF. K. T. SHAH

Regarding paragraph 4 of the draft report, I wish to dissociate myself completely with the sentence "The Indian Directors have failed to show initiative or power for withstanding such policies in India's interests." In my opinion it is neither correct in fact nor proper in taste.

Regarding paragraph 12 of the draft report, in my view under a system of Planned Economy, all inland remittance charges of every description should be abolished. Banking should be developed and facilities offered by banks provided on a scale and under conditions sufficient to make these facilities easily accessible to the average producer in agriculture and industry in this country. This can best be accomplished, in my opinion, by the widest possible development of the Postal Banking facilities, and the introduction of such systems as the Postal Cheque or the **Giro** system, which have been widely practised in a number of continental countries with excellent results.

Regarding paragraph 31, in my view a constant and careful control of prices, both retail and wholesale, is as necessary as it is unavoidable in a system of Planned Economy, if the very idea of planning is not to be frustrated. It is not enough merely to organise a machinery which would "prevent widespread or extensive fluctuations". The Planned Economy would not necessarily aim at mere "stability", but would, as I conceive the matter, regulate prices in such a manner as to be in harmony with the requirements of the Plan. And the Plan itself may have occasion, during the course of its being carried out, to lay varying emphasis on the different sectors of the National Economy, which may, therefore, involve varying the price level in accordance with the requirements of the Plan. The proposition, therefore, "that there need be no general scheme of price control either in the wholesale or in the retail market" seems to me to be incompatible with the idea of Planning.

NOTE TO THE INTERIM REPORT OF THE CURRENCY AND BANKING SUB-COMMITTEE

By

PROF. K. T. SHAH

Regarding the currency section of our report, one of our members feels that the approach to the problem of a sound currency system, appropriate to the Planned Economy, would have to be radically different from the one adopted in the report to the Committee as a whole. He would, therefore, like to point out that—

1. Money, in planned economy, should be confined to the original purpose of its first invention—viz. a tool of commerce, and not a tyrant.

2. A tool of commerce, to be efficient and serviceable, must have no other function which is calculated to pervert or defeat this original and primary function in the working of a community's economy.

3. Hence, except serving as a medium of exchange and a measure of value, money should not have any other function, like serving as a standard of value, or store of value.

4. If money is also to serve as a standard of value, with particular reference to its use as a measure of value, it must nevertheless be confined to value in exchange for the time being. It must be so ordained, regulated and controlled, as to be open to automatic adjustment to the changing needs of a community's economy, and its varying emphasis on any particular sector of that economy. Money, in other words, even if allowed to serve as a standard of value in exchange, must not be suffered to become a universal store of all values.

5. A standard of value, to be a real, useful and efficient standard, must be such as would be easily intelligible and acceptable to the commonest intelligence, and yet not one which would be of permanent character embodying some adventitious utility in itself, which would lead to the material selected to serve as standard becoming the dominant factor and governing principle of a community's economy.

6. Money should, accordingly, not be made out of any single commodity for all time, whether it is to serve as a simple medium of exchange, measure of value, or even as a Standard of value. It should preferably be made out of a number of

commodities of everyday use and general utility, whose relation **inter se** in exchange is a common phenomenon of daily life to the mass of the people. This relation need not be an invariable constant; but it must arise out of conditions of production and consumption which are fairly stable and generally understood.

7. For the sake of greater simplicity in daily transactions, any one or more of such commodities of general use may be selected to be a basis. Notes may then be issued by a Central Authority in terms of such a commodity or group of commodities in varying denominations. These notes may be ordained to be legal tender for all exchange transactions; and should be so designed, regulated and put into circulation, or withdrawn from it, as to serve absolutely no other function or purpose but the one of effecting an exchange. Like the postage stamp a currency note must be open to being cancelled after it has performed its functions.

8. If the commodity selected for such a basis is changed from time to time, there will be no temptation to use this material as a common store of value.

9. Money being made out of—or based upon—a number of commodities of every day use, the relation between credit and money should be the same as that between the commodities forming the basis of money, and the total wealth of the country. (Wealth is here taken to include both capital wealth, and income wealth.)

10. Credit must be organised and provided as a public service, and not as an individual obligation, indulgence, or privilege.

11. The basis of credit is the totality of the wealth of the community, and must be regulated, conditioned and supplied so as to promote the production and movement of such wealth as rapidly as feasible.

12. Price is an expression of the relation between the cost of production and the conditions of consumption of any given commodity at any given moment. In a Planned Economy prices would not be automatic adjustments and self-acting ratios, determined by the laws of Demand and Supply; but will be laid down, from time to time, by the central price-making organisation of the community, in accordance with the varying and different needs of the several sectors of the Planned Economy.

13. Local prices may be different from those for foreign markets; but the variation between wholesale and retail prices must be minimised as much as possible.

14. The foregoing is intended for money serving as medium of exchange within the community only, but the principle may serve also for regulating foreign exchanges.

15. No transaction of foreign commerce or foreign exchange should, if this principle is adopted, be permitted, except through a central banking organisation set up for the purpose. This does not necessarily mean nationalisation of the foreign trade of the country; but rather its co-ordination and centralisation for purposes of financing, so as to avoid any unnecessary strain upon the internal or external value of the currency system of the country. All banks operating in the country under the terms of a licence would be required to settle their foreign exchange transactions, if any, through the medium of the Central Banking Organisation or its department dealing with foreign exchanges. The best organised system of planned economy is liable to be upset completely by the forces working through the foreign trade of such a country, unless the entire system, including the foreign trade, is co-ordinated and centralised as indicated herein.

16. The foreign trade of the country may, however, have to be nationalised in proportion as the planned economy is achieved. Pending its complete nationalisation, there must be a progressively increasing control and regulation of its character and contents, direction and nature, where necessary by appropriate commercial treaties.

17. There is no intrinsic benefit in striving after "stability of prices". There should be thought given to "prices in the long run" as price is essentially a fleeting phenomenon.

A CURRENCY FOR INDIA

By

MAURICE FRYDMAN

In the beginning, articles of human need were simply bartered and the rate of exchange depended on the relation between demand and supply. With development of the agricultural life and trade the necessity of standards of value arose, and it is remarkable, that the first standards were based on articles of immediate necessity: grain, cattle, cloth. Further development of trade created a need for an easily portable standard and first metal in general and finally gold was adopted. Adoption of a gold standard used at that time for jewellery and vessels only, concides with a very high degree of general prosperity, when the demand for articles of first need was satisfied to a great extent, and when trade was catering to big towns and courts. Political development introduced State treasuries and a problem of replenishing them—large payments had to be made and this led to standardised metal pieces, called coins. Kings, usually badly in need of means of payment, manipulated with the coins, and their value decreased steadily, or in other words, prices were going up. Development of banking introduced paper values, which later developed into paper money by the same process of State manipulations. Ultimately paper money has replaced gold coins everywhere and gold has become now an article of trade, like any other, while currency and prices are ruled mainly by legislation.

The tradition of basing the value of paper money on the amount of gold the State will pay on demand is becoming more and more obsolete. There are very few States that will freely give gold to their citizens in exchange of paper notes. In international relations payment in gold is still current, but the general tendency towards balancing the imports and exports whenever possible by means of commercial treaties or currency depreciation has for its main purpose the elimination of gold from international relations.

The fallacy of gold as standard of value can be well shown if we take an extreme example.

A country called **Eldorado** is lined with gold bricks, but is, apart from this, completely barren. Its inhabitants will pay with gold for war material to protect themselves and

other goods to maintain themselves. The gold received in payment by the countries producing goods will be stored up in bank vaults and paper money issued to finance industry and agriculture to produce more goods demanded by our **Eldorado.** Provided the supply of gold bricks is big enough, the **Eldorado** State will flourish without producing anything, while other States will slave for it. The accumulation of war material may even lead to a political supremacy of **Eldorado** and all because other States have a fancy for hoarding up gold in their treasuries.

This may be an indirect test, but direct tests also show the unsuitability of gold as standard of value. The history of the last few hundred years of the West is a history of mankind suffering from gold poisoning. The production of gold does not go parallel to the development of the means of production and this leads to deep anomalies in the world trade and to periodical depressions. To consider them as natural would be to consider periodical attacks of malarial fever natural. They are signs of disease, of lack of balance between production and consumption, in short, of an unsound currency system.

The gold standard is also not moral in the sense of interfering with the self-evident right of every individual to self-expression. The shifting of the centre of gravity on a substance which is not an article of immediate and universal need has dislocated the attitude to life of the average man. Possession, and not service has become the goal. Everybody wants to have something, and not to be something and to do something. The harm, such mental distortion of outlook is doing to the individual and society cannot be over-estimated. Imagine the cells of your body obsessed with the idea of getting fat; some tissues, capable of collecting fat will become monstrously obese, while others, the brain and the nervous system first amongst them, will suffer acute emaciation. The bankers of the system, the heart and the liver will accumulate fat and will work lazily, which will lead to still bigger deposits of fat in some of the tissues.

To say that the same happens in our present-day society will not be an exaggeration.

To improve matters a change of attitude towards money is necessary. Gold is a static standard, it encourages possession, and not production and consumption.

Enormous amounts of human effort are spent on digging out the gold from one pit, called "mine" for putting it into another pit, called "bank". Since gold does not satisfy human

needs, it stands to reason that the labour is a complete waste. As a matter of fact paper currency could be issued on the basis of the gold content of the soil of the country with the same effect.

The very chemical stability of gold, praised by its partisans is rather a drawback. A depreciating currency would be infinitely better for the general welfare. But a depreciating currency alone would not be sufficient.

We do not maintain that currency reform alone will heal all wounds. It is not possible. Currency is only a tool, a technical detail of social organisation; but the right choice of a tool may have a far-reaching influence. Give mankind a standard of value that favours accumulation—it will accumulate. Give it another standard, that will encourage production and consumption—it will produce and consume with the same enthusiasm.

In our search for the most suitable form of currency for India we shall take the country as it is, and not as we would like it to be.

The main problem of India is the problem of a most appalling poverty, probably even worse than in China. One-fifth of humanity is living on or below the mere level of subsistence. The average income of an Indian is 7 ps. per day.

Poverty canot be abolished by State or private charity, however generous and extensive. One may be fed on doles, "Winterhilfe" "Soupes popularies" or "National relief funds" and yet remain in the same state of wretchedness. All the unemployment schemes, etc., are nothing but production of beggars on a mass scale. Workmen dislike intensely these schemes; unearned bread is tasteless for them. They postpone physical starvation, but mental and moral starvation remain the same. Vast millions are reduced in their human dignity and their capacity for work is wasted.

In India no unemployment or poverty-relief is yet organised. It is natural because poverty and unemployment are too general. Contrary to other countries, total employment is the privilege of a minority here. The vast majority of the population is partially or totally unemployed. All the resources of the employed part of the population will not be sufficient to finance even the most modest unemployment scheme.

Complete abolition of poverty involves a thorough economic reconstruction of which a currency reform is a single aspect only.

Whether it will take in India the shape of a State socialism, or of a God socialism, it is not for us to venture an opinion.

Thus, the system of currency we are in search for, should be designed so that its working automatically tends to diminish poverty, in other words: (1) It will favour production; (2) It will facilitate proper distribution; and (3) It will encourage consumption. Apart from this the proposed currency should be easily understood and accepted by the poverty-stricken man himself, i.e., it cannot be an abstract currency, based on price indexes or other statistical averages.

In looking through the list of human needs we find that the first is food. Its importance is out of proportion to any other. In moments of distress the satisfaction of all other needs will be sacrificed for the sake of food and family affection only proves sometimes equally strong. Food being the first necessity it is also the biggest single item of man's production. More effort is spent on the production of food than on everything else taken together. Food is also the item in which insufficiency of production, distribution and consumption is most intolerable. It makes the availability of all other necessities of life worthless.

Let us imagine that by some magic, India is deprived of all amenities of civilisation but given an abundance of pure and healthy food. A nation of well-built nudists, walking briskly from Rameshwaram to Badrinath for a stroll, begetting sturdy little boys and girls in a happy promiscuity, worshipping, if at all, **Sri Annapurna** only and friendly to each other because there would be absolutely no reason for being otherwise, may look grotesque to our worry-eaten minds, but whoever loves man for his own sake will not deny that it would be an acceptable proposition.

Food being the first and by far the most important need of man, which, when required, will be willingly exchanged against anything else, the following idea occurs immediately.

Why should not the most common and urgent necessity be made a standard of value? Will it work better? Will it fulfil the requirements of India? Will currency based on a food standard be the "morally sound currency" system for India?

The first thing to note is that a food currency is not a new idea. It exists and works on a small scale in all purely agricultural communities. It still exists in the Indian village economy. It is in harmony with Indian traditions. It is in the very blood of the villager, and the villager is India.

In ancient times gold coins were stored by tradesmen, kings and temples; the villager knew paddy only. Till very

late even taxes were paid in grain and the only contribution to be paid in gold and silver were the homages offered to the ladies of the household.

The introduction in India of a foreign economic and industrial system has destroyed the village economy and ruined the very foundation of the country's prosperity. Everything had to be paid with money, with **rupees, annas, pies** and money has become a nightmare. Its value in terms of grain was changing constantly. Significant is the fact that the villager says :"so many measures of rice for a rupee" and not "so many rupees for a measure of rice". It is because he had to purchase rupees, and never rice. He had to purchase rupees for payment of taxes, debts, implements, cloth, etc. Yet, in his mind, grain remained the standard of value and not money, which he had to get to pay off all his harassers till the next season.

Let us now make clear, what exactly we mean by the term "food currency"; with its introduction, what would be its influence on the agricultural and industrial life of the country, in what way will it affect production, distribution and consumption and how will it influence Indian trade relations with other countries.

By "food currency" we understand a system of currency in which a staple food product of the country is taken as a standard of value. In India it will be a chosen variety of paddy and wheat. A certain quantity of paddy and an equivalent from the nutritive point of view, quantity of wheat will be chosen and called a rupee. To distinguish it from the old rupee the new rupee may be named **food-rupee.** For purposes of convenience the food-rupee standard may be so chosen, as to represent the value of a rupee in terms of grain at a rate most suitable from all points of view.

Legislation will have to be passed: (1) to convert all gold obligations; (2) to control the import and export of currency grains; (3) to open State granaries, (4) to fix once for ever, the quantity of currency grain in a **food-rupee**, (5) to fix the seigniorage levied by the State when exchanging currency grain for currency notes.

The seigniorage is necessary to avoid the Government to become a merchant in grain. It may be one to two annas in the rupee, which will allow a margin of profit to all big and small grain merchants that will continue their trade within the limits of seigniorage, similar to the gold brokers of to-day.

The State granaries do not need to be many nor very big, if free railway transport of State grain is introduced, every

station master may be authorised to issue food currency notes against currency grains and send the bags of grain to the State granaries.

Private hoarding of food currency notes will be prevented by proper legislation devaluing old currency notes, unless deposited in savings banks.

An additional legislation of immense importance, although not directly connected with the currency reform would be the transfer of a part of land revenue to a Crop Insurance Fund, out of which compensations for total or partial crop failures will be paid.

Let us now visualise the change as clearly as we can. We shall assume that the reform is already about 3 years old, and the storm of protests, declarations, petitions, resolutions and interpellations has subsided and the big grain merchants have chosen another field of money-making, that the villagers have thoroughly learned the welcome news that there will be no more variation of price of crops, however abundant the crop may be and the grain consumer has also learned that he does not need to pay grain above a certain rate, printed on every currency note in his pocket. The grain ports are usually deserted. Apart from this not much more changes will be found in the towns.

The real importance of the reform will be seen in the village. Every plot of land becoming virtually a gold mine and every villager a gold digger, unusual activity is observable everywhere. Grain has verbally become money—by growing grain money is grown—and everybody knows well in advance how much money is going to be grown. Every piece of land is utilised, irrigation schemes are put to execution, the selected grain varieties are sought for, agricultural improvements quickly popularised, best implements purchased, every village humming with activity, because for the first time in history the grain grower is sure of the crop, its price, its market.

Demand and supply relations govern other agricultural products, and their culture will not be forsaken, as their price will be always controlled by the value of grain that can be grown on the same land with the same amount of labour and usually they bring some small premium to the enterprising grower.

Every villager knowing exactly how much value he is growing every year, is enabled to lay out a budget and to have his own private 5-year plan. The indebtedness of the village

has become possible to cope with, as the stabilised income of the villager has enabled the State to give long-term interest-free loans on the security of the crops.

The industrial development of the country is tremendously accelerated. The currency notes the villager receives for his grain he has either to spend or to save. He spends on industrial products like carts, bullock shoes, lamps, hardware, paper, etc. The amounts saved are utilised by the Government for financing big irrigation and electrification schemes, reclamation of waste lands, building roads and railways. In both cases the money goes to the industries. As the industries develop and their own costs go down, prices of industrial products in terms of agricultural products go down, enabling the villager to purchase more and more. Thus the development of industries follows closely the rise of prosperity in the villages.

The State has profited in several ways. Its land revenue is stabilised and growing from year to year. The seigniorage has created a new source of income. The prosperity of the population is increasing steadily, any local famine is dealt with by the Crops Insurance Fund, and there is plenty of reserve funds for any major scheme. Food, being the currency itself, no need of curtailing its production is ever felt; when abundant quantities accumulate in the granaries, extensive sanitation, town building and road building schemes are financed, educational facilities extended and children, maternity and old-age protection schemes introduced. Heavy inheritance taxes curtail the accumulation of too big savings, money is grown intensely and spent intensely and proper balance between production and consumption maintained all the time.

Except for the severe control of currency grains imports and exports, little change can be observed in the international trade mechanism. The **Food-Rupee** being an internal currency, the international trade accounts are cleared by a special bank agency which keeps foreign money and gold stock for smoothening out the differences between exports and imports. The country's gold production, useless now for the internal economy, is more than sufficient to meet any foreign obligation, if they have to be paid in gold.

Needless to say that although the food currency will make a tremendous difference in the economy of the country and may open a new era in its development, as long as the land will be in the hands of landlords, it will make them very rich and also very dangerous. The new scheme will benefit them in the first instance. The tenants, usually left with just enough

to live on till the next season, will get their benefits only indirectly, owing to increased demand for industrial and rural labour.

Yet any failure to give plenty to every individual in India will not be the fault of the currency system, but of other aspects of the present economic structure. The scheme by itself is able to foster production, facilitate distribution and increase consumption.

Can the reform be introduced immediately? Surely. It will make everybody's life easier. It requires a very simple legislation. It benefits the State and the citizen in the same measure.

Can it be introduced in a smaller area than the whole of India? Yes, provided two conditions are fulfilled:

(1) The chosen area can grow some excess of food over the needs of the population; (2) Its revenue is entirely independent and it has no outside charges; and (3) It has got freedom to regulate its imports and exports.

Some objections may arise and it will be useful to answer them in anticipation.

(1) Is it necessary to make food the currency itself? Will not a grain price policy based on State granaries do the same?

No, it will not do, as although it stabilises the prices to a certain extent, it will always be subject to the whims of the Governments and does not give the certainty, that the food currency itself can only give. Apart from this, the gold poison will not be eliminated.

(2) Will not a food currency lead to over-production of grain? No, because human needs are various and with the increase of prosperity the population will create a demand for other agricultural products, that will become more paying to produce, than grain.

(3) The food currency will foster barter transactions in the rural areas, with the elimination of currency notes.

It would be a welcome procedure, eliminating the middleman completely and giving to those concerned the full value for their services.

(4) It will be difficult to collect taxes in grain.

Taxes will be collected as usual, in currency notes. Exchange of grain against currency notes is done separately, preferably by the station masters.

(5) The State will incur heavy losses by accidental deterioration of grain.

The modern granaries can keep grain for very long periods. If the reform is passed by the Government, we undertake to design air conditioned and ventilated granaries in which grain will keep as long as in the Egyptian Pyramids.

(6) A heavy load will be put on railways.

Not at all; State granaries will not be big at all. The majority of grain transactions will pass through private hands, who will desire to profit by the seigniorage. Apart from this the increased railway traffic, due to higher prosperity, will pay off the railways generously the necessity of sending a train-load of grain free.

(7) Excess of grain will accumulate in State granaries.

Grain is a starting point in a variety of chemical industries. It can be dumped away by the State. A large percentage of currency notes issued will never be claimed to be exchanged for grain and the excess of grain can be sold to licensed chemical industries at lower rates or exported.

It is impossible in a single article to go into all the details of the scheme and to discuss all the corollaries. However Utopian it may look at the first sight, it is a simple, understandable scheme. It deserves consideration—and we are sure that a generation will come that will take it seriously and put it to practice.

NOTE ON REGUATION AND CONTROL OF FOREIGN EXCHANGES

By

K. T. SHAH

1. Recent experience has found that no country trading with other countries on any considerable scale is able to maintain on an absolutely uncontrolled basis the international value of its unit of money in terms of the currencies of other countries, not only because the foreign trade of most countries today is not free, but also the movement of funds between the different countries is a subject of so much regulation and control, that leaving the foreign exchanges of a community uncontrolled would only expose such a country to needless losses.

2. The Foreign Exchange business of this country has, in a manner of speaking, been regulated and controlled, at least indirectly, by the Rupee being linked to Sterling at a fixed ratio. Since 1893, when the Indian Mints were closed, and a gradual process of artificial scarcity of the Indian currency unit led to a steady appreciation of the exchange value of the Rupee, till it reached a point desired by Government as the reasonable ratio in or about 1898, the Rupee is supposed to be fixed in terms of Pound Sterling at 16d. to the Rupee, or 15 Rupees to the Pound. Government at first bound themselves to maintain this ratio on either end by giving freely rupees in exchange for gold at this rate, when the balance of accounts was heavily in favour of India, and the rupee was in high demand; and, when the balance of accounts went against India to give gold at the prescribed rate in exchange for the Rupee currency. A small fraction was permitted to cover the cost of remittance at either end of this fixed exchange ratio.

3. Sterling was, of course, taken to be synonymous with gold; and, as London was assumed to be a free market for gold, where gold and sterling exchanged freely at a fixed rate, it was felt unnecessary to insist upon any corresponding regulation of Sterling. The variations in the exchange value of the Rupee in terms of any other currency followed the fortunes of Sterling in respect of these currencies; and as most of the leading countries had their currency between 1899 and 1914

based upon gold, this implied a pretty stable level of international exchanges.

4. The gradual process by which the variation in the arrangement made in 1899 as regards the Exchange value of the Rupee and its props came to be modified need not be detailed at length here. In ordinary times there was always a balance of trade in favour of India, sufficient, not only to pay for the so-called "invisible" imports into India, but also to leave a surplus which was paid for in specie (gold or silver). This was formed into a reserve for use on the day when the balance of accounts might go against India, and the Rupee should depreciate in the international market. At first this reserve was kept in India mainly in gold, and called the Gold Reserve Fund. Silver needed for the coinage of Rupees was purchased out of this balance in favour of India, and the profits on the minting of Rupees was added to the reserve. Every rupee coined in those days meant a profit of 6 or 7 annas to Government; and as the balance of accounts in favour of India continued to be substantial, vast amounts of rupees were coined, and profits put into the Reserve.

5. After two or three years' experience of the working of this arrangement, it was decided to transfer a portion of the Reserve to London, as being the freest gold market in the world, where, whenever necessary, India could obtain her gold with the same ease and freedom with which other countries were supposed to obtain their gold deposited in London. Further, as Sterling was regarded as equivalent to gold, and as British Government securities were regarded as the best "gilt edged" securities in the world, a portion of the Reserve thus formed out of the profits of Rupee coinage came to be invested in Sterling securities. In the first big crisis before the world-war, namely 1907-08, when the exchange value of the Rupee threatened to depreciate, there was a forced sale of some portion of the Sterling securities in this Reserve at considerable loss. A loan was also needed to maintain the Sterling value of the Rupee at the fixed point.

6. This experience, however, did not serve to open the eyes of the authorities to the fundamental wrong of their fixed exchange system from the point of view of the Indian national economy; nor did it demonstrate the error of regarding gold and sterling as synonymous, or considering sterling securities as being as good as cash gold. A correlation was in fact established, in the years that followed, between the so-called Gold Standard Reserve, the new name for the old Gold

Reserve, and the Paper Currency Reserve, which was also kept increasingly part in gold, part in Sterling securities, part in Rupee securities, and part in silver and gold coin or bullion. By this facility it became unnecessary to buy silver and coin rupees every time there was balance in favour of India. A mere addition to the Paper Currency with an equivalent addition to the reserve would suffice.

7. The Gold Exchange Standard, which was the new name given to this arrangement, implied that the Rupee would be maintained at a fixed value in terms of Sterling,—not gold. Sterling was, of course, still taken to be equivalent to gold; and capable of being exchanged against gold any time when the exigencies of the international exchange market so required. Since a considerable amount of the Reserve was being built up year after year,—and kept in sterling and rupee securities, gold and silver coin as well as bullion,—in normal contingencies it was felt that a fair proportion of this Reserve would not be required for its primary objective, namely, the maintenance of the Exchange value of the Rupee. It was, accordingly, invested in ever growing volume in securities, which were assumed to be easily marketable without any serious depreciation. The bulk of these securities were securities of the Government of England. A growing proportion was also made up of Rupee securities, which was part of the Paper Currency Reserve.

8. The strain imposed by the World-War showed itself, first, in the form of an increased value of silver. The Rupee as a fixed weight of silver, also grew in value, and a steady, progressive depreciation of the Sterling in terms of gold, as represented by the American Dollar followed. The requirements of War led to India assuming considerable obligations on behalf of the British Government, for operations in the so-called "Near East". This more than set off the balance against India on account of the so-called "Invisible Imports". A considerable and increasing balance of exports from India over her imports, which were reduced substantially owing to the diversion of industry in the principal customers of India to war purposes, and because of the submarine menace, also led to the same result, namely, the stiffening of the exchange value, in terms of Sterling, of the Rupee. An attempt to maintain the fixed exchange value of the Rupee by introducing paper currency of lower and lower denominations, so as to spare the necessity of buying more silver and coining more rupees, which now left ever diminishing profits, did not quite succeed. Government were accordingly obliged to raise the

Exchange Value of the Rupee gradually, nominally to make for the greater cost of transport and Insurance of silver in war-time; but in reality because exchange was impossible to be maintained at the value originally fixed of 16d. to the Rupee, notwithstanding the pegging of Dollar-Sterling Exchange for the duration of the War.

9. At the end of the War, when European control over exchanges was removed, the depreciation of the Sterling in terms of gold, or of the American Dollar became more marked than ever. As the Sterling value of silver also rose, and as the Rupee representing silver became more valuable in consequence, the authorities responsible for the maintenance of the exchange value of the Rupee decided to fix a new level at two shillings per Rupee, on the hypothesis that silver had permanently improved in value in proportion to gold to this extent. The experiment, however, was disastrous, though Government tried for six months, by means of Reverse Councils, to maintain this new ratio. The consequence involved heavy losses to India, and depression of the reserves, which would otherwise have been built up.

10. By the end of 1921, or early in 1922, the Rupee once more returned to its pre-war level in terms of Sterling. Sterling also gradually improved, and when the Gold Standard was substantially restored in England in 1925 at the pre-war level, —notwithstanding the differences in the cost of production and altered conditions on international trade and money market,—the position of the Rupee had to be reconsidered. Artificial scarcity in the supply of the Rupee and of the representative forms of currency in India led to a new stiffening in the value of the Rupee till it was brought to 18d. in the exchange market. At this point another Royal Commission on Indian Currency and Exchange advised and the Government of India fixed the exchange value of the Rupee, in terms of Sterling, now again taken to be equivalent to gold, notwithstanding intense opposition from Indian opinion to this change.

11. On the advent of the World Depression this position had already been shown to be inimical to the interests and demands of India's national economy. With Sterling itself breaking away from gold, the case for maintaining the same ratio, even in Sterling, of the Rupee became more than ever difficult to defend. Government, however, persisted in maintaining the fixed sterling rate, and practically killed the export trade of India by 1932. The balance of accounts was definitely and heavily against India; and so a heavy drain of gold set

in from India. This helped to maintain the exchange value of Sterling, though diminished considerably, at a fairly steady level. Indian trade became penalised, till it dropped to 1/3 of its old level, and the Indian producer suffered in proportion. The drain of gold also involved considerable weakening of the base for the credit system of India. The capital resources of the country also became reduced, and industrial advance checked, all because of this peculiar kind of control and regulation of the exchange value of the Rupee in the interests rather of the British public economy, than of India's.

12. The lessons learned from this brief history of the Exchange policy of the Government of India may be divided into the following main categories:—

(i) Automatic adjustment of the exchange value of the country's monetary standard in terms of gold is impossible in these days of universally controlled international trade and regulated exchange.

(ii) Sterling is not, and cannot be considered to be ever likely to be equivalent to gold, in matters of International Exchanges. Conditions of production and trade in principal country have altered radically; and London is no longer the central money market of the world, or a free centre for buying or selling gold. It would, therefore, be fatal to India to link her national currency system to Sterling by fixing the exchange value of her local currency in terms of Sterling only.

(iii) If, as is evident from world experience, regulation of exchange and control of trade are inevitable in the interests of the country's national economy, that regulation and control must be in the interests of the country's own economy, and not for any extraneous reasons, such as those which have influenced the Indian currency authorities hitherto in the regulation of India's exchange policy.

(iv) Given the volume, variety and value of India's foreign trade, and notwithstanding the burden of the so-called "invisible" imports, India has sufficient strength of her own to regulate successfully the exchange value of the national medium of exchange from her own resources; and in conformity with the needs of her own national economy.

(v) The exchange value of the local medium of exchange has a close bearing on the internal level of prices in so far as it is influenced by international price-level; and consequently, on the degree of success open to the local productive organisation.

(vi) The price-level is made up of the inter-connection between the volume of currency of all forms,—including metallic money, paper money, and credit instruments used as substitutes for paper money,—and the volume of transactions needed to be carried out in order to run the aggregate economic organisation of the country.

(vii) For maintaining the price-level at a given point, we could operate on either side of the equation,—by controlling the volume of money acting as currency, as well as by controlling the organisation of production and consumption. In a planned economy both would be equally feasible.

(viii) The link between the paper currency and the metallic currency, as well as with the so-called deposit currency, and, therefore, the credit system of the nation, is thus of the strongest and closest and the most delicate; and would require very careful and constant control and regulation.

(ix) The different forms of money used under present conditions in this country are given in the Introduction and in the Summary of Developments.
A proper correlation is necessary to establish between all these forms and their use in carrying on the planned system of national economy in production as well as consumption.

(x) The authority entrusted with the control and regulation of this co-ordinated system must be in India, responsible exclusively and entirely to the Government of India, which, in turn, must be responsible wholly and solely to the representatives of the Indian people.

12. The Paper Money in India is expressed in terms of the Rupee, which is itself only a fraction of the Pound Sterling, which, in its turn, is a varying—and today a depreciated—quantity. Our Paper Currency is founded upon a cent per cent reserve, consisting of 40% of actual gold, and sterling securities, and the balance in silver—coined or bullion and

rupee securities. The following table shows the value of Paper Currency and its circulation and the constitution of the Reserve held against it.*

It is managed by the Reserve Bank of India since 1935. Previous to that it was managed by the Finance Department of the Government of India. The concentration of the currency and credit systems in the Reserve Bank of India, permits a closer link between the credit system, the currency system and the exchange policy of the country. But we cannot say, even now, that India's Exchange policy is run in the best interests of this country, and of this country only. So long as the Reserve Bank is a private corporation, however closely controlled; and so long as its conduct and management are outside the control of a Responsible Government of India, there can be no hope, no guarantee, that the Exchange Policy of India would be conducted entirely in the interests of this country only.

13. If the monetary system of the country is recast as suggested elsewhere, so that Money becomes purely and simply a medium of exchange, and a temporary measure of value,—without being an invariable standard of all values and much less a store of value—the regulation of its exchange value would be a relatively easier function. The most important consideration would then be to maintain the productive organisation of the country, and adjust it automatically to the consumption side of the national economy. A price-level may then be assured from time to time, which would permit of the disposal of the commodities produced on a basis of reasonable advantage to the producer and at the same time in accordance with the capacity of the consumer. The interests of the consumer would demand a price level corresponding to the cost of living, so as to be well within the means of an average consumer. In an organised social system of planned economy, however, the distinction between the producing and consuming interests in the country would not be quite so important, as every consumer would also be, directly or indirectly, present or potential, producer. What would benefit the producer in the first instance would not necessarily be antagonistic to the interests of the consumer. For an identity of interests, however, to be established between producers and consumers, the element of private profit, or surplus value monopolised by any class of the community, would have to be progressively reduced, till it is eliminated altogether. The variations in the

*For this see the Introduction and the Summary of Developments.

price-level from time to time would then be merely in response to the varying emphasis on the several sectors of the planned National Economy; and not in response to the insatiate search for private profit to the speculative entrepreneur. Nor would it be liable to be influenced as closely as today by every change of policy or economic influence affecting the price-level in foreign countries. It would also not cause that dislocation of the national economy which often happens under the present non-regulated system.

14. With a co-ordinated system of national control over the Foreign Exchanges of the country, no transaction in foreign exchange would be permitted, except through a national central banking organisation specially instituted for the purpose. The Reserve Bank may serve this object provided it is free to do foreign exchange business, has sole control of all available reserves, acts exclusively in Indian national interests, is responsible wholly and solely to the Responsible Government of India, and is a national institution in every sense of the term, in outlook as well as ownership, in conduct as well as control.

15. For a satisfactory conduct of India's foreign exchange business, it would be necessary that the entire foreign trade of the country with other countries should be financed through the Central National Bank mentioned in the preceding section. All Bills of Exchange and other documents of the kind should be domiciled with that bank in the ultimate instance; and the transaction represented thereby should be liquidated or carried out only through its agency. The Bank should deal with the corresponding Central Bank of the country with which a given exchange transaction has to be carried out,—or with which all exchange transactions in a given period are to be carried out. By this means the aggregate financing of the foreign trade of India with each customer country would be possible to conduct on a basis of the least use of specie for settling the final balance. The Reserve Bank may, if so advised, keep a given proportion of its balances in the liquid securities or commercial paper of the leading foreign countries not of one only; so that at times it may utilise these sources to avoid a needless movement of specie for settling international balance of accounts. By this process, the imports, into India, including "invisible" imports, will be set off against the Exports including "invisible" exports, between this country and any other customer country, and only the balance will have to be settled with each country and that would be very considerably reduced.

16. If an international clearing house is established,—as has already been foreshadowed in the creation of a Bank of International Settlements with its head-office in Switzerland,—the outstanding balance of accounts as between the different countries will be set off every year one against the other, in the same manner as in the clearing house in a given money-market all cross claims between the several parties are settled by mere book entries, debit or credit as the case may be, in the central banking institution serving such a clearing house; and no movement of specie need take place.

NOTE ON REGULATION OF MONEY & CREDIT

By
K. T. SHAH

1. Money, in planned economy, should be confined to the original purpose of its first invention—viz., to act only as a tool of commerce, and not as a tyrant.

2. A tool of commerce, to be efficient and serviceable, must have no other function, which is calculated to pervert or defeat this original and primary function, in the working of a community's economy.

3. Hence, except serving as a medium of exchange and a temporary measure of value at any given moment, money should be allowed to have no other function, like serving as a standard of value, or store of value. No single commodity can possibly serve as an ideal standard of value, which remains itself unchanged, in its relation to all other commodities or services changing in ratio constantly **inter se** mainly because of the changing conditions of the production and consumption of the several commodities and services. Only an abstract aggregate of all such ratios can, if at all, ever express a steady exchange relationship between the commodities and services forming the subject matter of trade.

4. On the other hand, if a commodity also serves as a store of value and a means of deferred consumption, it is likely to act so as to deflect the balance between production and consumption which is essential to maintain if a system of planned economy is to be carried out consistently and satisfactorily.

5. If money is also to serve as a standard of value, with particular reference to its use as a measure of value, it must nevertheless be confined to Value in Exchange for the time being only. It must be so ordained, regulated, and controlled as to be open to spontaneous and immediate adjustment to the changing needs of a community's aggregate economy, and the varying emphasis on any particular sector of that economy. Money, in other words, even if allowed to serve as a Standard of value in exchange, must not be suffered to become a universal standard of all values; and much less should it be

permitted to be a store of value, or means of deferred consumption at unabated or unaffected level.

6. A standard of value in exchange, to be a real, useful and efficient standard must be such as would be easily intelligible, and universally acceptable to the commonest intelligence. At the same time, it must not be one which would be of a permanent character embodying some adventitious utility in itself, which would lead to the material selected to serve as such standard becoming the dominant factor and governing principle of a community's economy, moulding and working it, not in accordance with the aggregate needs of the community's total economy, but rather in response to the needs or interests of those who own this money, or can control its volume and employment.

7. Money should accordingly not be made out of any single commodity of direct value in itself. It must not be intended to bear a fixed or steady ratio for all time with other commodities whether it is to serve as a simple Medium of Exchange, Measure of Value, or even as a standard of value. On the other hand, it must be so organised as to be of easy and universal acceptance and use for the one purpose for which it is intended and designed, viz., facilitating exchange of commodities from the producer to the consumer. It should, accordingly, be made preferably out of a number of commodities of every day use and general utility, whose relation **inter se** in exchange is a common phenomenon of daily life to the mass of the people. This relation need not be an invariable constant; but the variations, if and when they occur, must arise out of conditions of production and consumption, which are fairly stable and generally understood. For this purpose it would be necessary to construct an abstract standard or measuring rod, the so-called Index Numbers, compiled out of a number of articles of everyday use, selected on as wide a basis as possible, with all due weightage to each single item included, which must all be familiar to the people using them. This may next be represented in the form of a Currency Note expressed in units of the most considerable commodity in the list, which should be printed as a whole on the back of the note, and be made an obligation of the Central National Bank which controls the entire trade of the community at home and abroad, regulates the productive organisation, and generally supervises the collective national economy.

8. Currency Notes in this form may then be issued by the Central National Bank in terms of such a commodity in varying denominations. These notes may then be ordained to

be legal tender for all exchange transactions. They should be so designed as to serve absolutely no other function or purpose but the one of effecting an exchange like a cheque or a bill of exchange valid only up to a given date, or a postal stamp which is usable only once for a stated service and then cancelled. If the commodity selected for such a currency system is changed from time to time, and the exchange value of that commodity in relation to others is made a varying quantity, there will be no temptation to use this material as a store of value; for there will be no guarantee of the notes of any particular date, expressed in terms of any particular commodity retaining their relative value, or legal tender validity.

9. As a condition precedent and indispensable preliminary to this reorganisation, the Central Banking Institution of the community must have the sole custody of all reserves, and absolute control over all credit transactions, relating to commercial dealings between all classes within the country and with other communities. For this purpose, it must have sole charge of all valuta, all stocks of such materials as serve for money in any foreign community, and control and regulate their transfer from producer to consumer, and of all movements of 'capital' to and fro on account of the community.

It may be added that, for purposes of settling the international balance of accounts, we may adopt gold, or any other article accepted by the world in general as a medium to settle the balance.

10. This Central Banking Organisation of the community must necessarily be a nationalised institution of common interest and concern to all sections of the community. No transaction of foreign commerce or foreign exchange should be permitted except through this central nationalised banking organisation of the country; and all internal exchange transactions must eventually be settled finally through its intermediation as a final clearing house.

11. The foreign trade must be nationalised in proportion as the planned economy is achieved. Pending its complete nationalisation, there must be a progressively increasing control and regulation of its character and contents, its volume and direction, where necessary by appropriate commercial treaties. This must include all 'invisible' imports and exports which affect the country's international balance of accounts, and so react upon the international exchange value of its currency.

12. Pending the nationalisation of the Central Banking Institution of India, and completion of its monopoly of the

foreign exchange business of the country, a growing proportion of that business arising out of the foreign trade of India should be progressively secured for Indian banks. When it is so secured, it must gradually be transferred to the Central Nationalised Banking Institution as the sole operator in that field.

CREDIT

1. Credit must be organised and provided as a public service, and not as an individual obligation, indulgence, or privilege.

2. The basis of credit in a community is the totality of the wealth of the community. It must, accordingly, be regulated, conditioned and supplied so as to promote the production and consumption of such wealth as rapidly as feasible.

3. Individuals as such need not be concerned in the grant or use of credit. They must be organised in co-operative or collectivised corporations engaged in the production or distribution of any commodity or service, to which alone credit should be made available. When thus made available, it must be used for such purposes only as may be specified in the instrument of credit. In a system of properly planned economy there would be no need for private individual credit for any non-productive purpose which has hitherto occasioned the largest amount of indebtedness of the Indian producer.

4. Money being made out of index numbers based upon the average prices of a number of commodities of every day use, the relation between credit and money should be the same as that between the commodities forming the basis of money, and the total wealth of the country. Wealth is here taken to include both capital wealth, and income wealth, goods as well as services of all kinds, including administration and management, health and education, travel, amusement and recreation.

NOTE ON PRICES

By

K. T. SHAH

1. Prices are an expression of the relation between the cost of production and of consumption of given commodities. In a planned economy these ratios would not be determined by the so-called laws of Demand and Supply; but will be laid down, from time to time, by the central price-making organisation of the community, in accordance with the varying and different needs of the several sectors of the planned economy.

2. Local prices in regard to the same commodities, may be different from those for foreign markets but the variation between wholesale and retail prices will have to be minimised in a planned economy as much as possible.

3. The influence of the middlemen and advertising must be progressively reduced, and ultimately eliminated, as an unjustifiable tax for private benefit on the producer as well as the consumer. This will tend to keep prices,—wholesale as well as retail,—as near one another as possible.

4. There is no intrinsic benefit to the national economy in striving after "stability of prices". The Plan would itself take care of this matter. There should be no thought given to "Prices in the long run" as price is essentially a fleeting phenomenon.

NOTE ON REGULATION OF BANKS IN INDIA

By
M. L. TANNAN

The chief reasons for subjecting Banking to Government regulation should be evident to those who have given any consideration to the subject. In the first place, banking gives such a tremendous power as a result of its loaning function to those engaged in this business that it has been sometimes suggested that the state should have a monopoly of the same. Secondly, the whole structure of banking rests upon public confidence and once it is shaken the structure is liable to fall to the ground more so in a country like India in which joint stock banking is in infancy. Thirdly, as bankers carry on their business mainly with funds deposited with them and consequently they have a large proportion of the floating capital of the country in their hands, it is essential to regulate their business to minimise the risks of their failure. Fourthly, government supervision of banks is considered necessary on account of their close relationship with the economic structure of a country.

The Bank failure of 1913-15 clearly proved that it was unwise to apply the policy of **laissez faire** to Banking matters in this country and agreeing with this view the Banking Inquiry Committee recommended the passing of Banking Legislation. However, as the amendment of the Indian Companies Act was undertaken soon after the report of the said Committee was submitted, Government were content to provide some safeguards for the protection of the interests of the depositors and shareholders of banking companies by means of a few new provisions in the Companies Amendment Act, 1936, and thus the said recommendation was shelved. While it is true that the provisions referred to above are very useful they cannot, however, be taken to have done away with the need for a Banking Act. In addition to the provisions already made in the Indian Company Law and the Reserve Bank of India Act, legislation in the following directions appear necessary:—

1. It is generally admitted that some regulation as regards the capital of a joint stock bank is necessary and it is, therefore, provided in the Indian Companies Amendment Act, 1936, that no bank can start business unless it has a paid up

capital of Rs. 50,000. Additional capital should be required for every branch which a bank may open and its amount should be substantial in case of branches in Presidency towns. The Reserve Bank of India should be empowered to fix the amount in each individual case though some guidance in this connection may be given in the proposed Banking Act.

Moreover as the profits of every commercial bank depend largely on the amount of deposits it can attract it is but natural that the authorities of a bank would ordinarily try their best to increase its working capital by means of deposits. On the other hand, in case a bank suffers losses beyond its capital and reserve fund its depositors are bound to be hit. In order to provide certain minimum security to the depositors it is very desirable to lay down a minimum percentage which the paid up capital and the reserve fund of a bank must bear to the total deposits.

2. As the depositors of a bank provide 80 to 95% of its working capital and as they have no hand in the appointment of the statutory auditor, they should be allowed to appoint their own auditor as is the case with the policy holders of certain life assurance companies subject to the condition that the remuneration to be paid to such auditor shall not exceed that paid to the auditor appointed by the shareholders. It may also be considered whether the depositors of a bank should not be allowed to nominate one or more directors of a bank.

3. It is generally admitted that no great protection is afforded to the depositors of a scheduled bank by requiring it to maintain with the Reserve Bank of India a minimum daily balance equal to 5 per cent of its demand liabilities and 2 per cent of its time liabilities. It is, therefore, considered necessary that the scheduled banks should be required to have a certain minimum proportion of their demand deposits in government, semi-government securities or genuine commercial bills.

4. The need for distribution of risks necessitates a restriction on the powers of a bank to loan to a person or firm, company or corporation a sum exceeding say 10 per cent of its paid up capital and surplus. In case of bills maturing within six months and with two unconnected signatures the percentage may be raised to 15.

5. With a view to prevent commercial banks from locking up large amounts of money in properties it should be laid down that no bank other than a mortgage bank should hold immoveable property except that required for its own use or

shares in real estate companies for more than five years. Such properties as may be taken in settlement of bank dues should be got valued by independent valuers within 12 months after they are acquired and no income from such properties should be credited to the profit and loss account unless adequate provision for their depreciation, if any, has been made.

6. In order to prevent a bank from inflating its profits the law should lay down that in the case of accounts in which the actual payments, if any, during the preceding twelve months do not even come up to the amount of the interest debited to such accounts, the interest earned in excess of actual payment should be credited to Interest Suspense Account and not to the Profit & Loss Account. Amounts so credited should be transferred to the Profit & Loss account of the period or periods in which actual payments are made.

7. Every bank should be required to show in the balance sheet book debts for which suits have been filed or decrees obtained separately from other book debts.

8. Banks should ordinarily value their assets at cost or market value whichever is lower and in cases in which they are shown at higher figures than their cost, the same should be required to be stated clearly in the accounts to be presented to the shareholders.

9. Provision should be made for the periodical inspection of the accounts of the scheduled banks by the Reserve Bank of India which should be empowered to call for any information regarding the working of any bank in British India.

10. Among other causes responsible for the failure of joint stock banks in the country the absence of a sufficient number of suitable directors from bank boards is quite important. A bank director need not necessarily have a practical knowledge of bank but he should understand the fundamental principles of banking. He ought to know the importance of liquidity and safety of the assets of the bank. He should see that his bank avoids long term commitments. It should be understood that credit is to be given on a business basis and not on the basis of personal friendship or self-interest. Similar considerations should apply to the recruitment of staff. It is, therefore, necessary that before a bank is registered, the Registrar of Companies should satisfy himself that among the promoters of the bank there are persons suitable for being appointed as directors.

11. The Banking Act should also provide adequate protection to Banks against malicious attacks by spreading false rumours, etc.

12. With a view to simplify the liquidation of the failed banks and to bring to books those responsible for the infringement of the law or indulging in unsafe or unsound practices in their management it is desirable to entrust except in the case of very small institutions the work of liquidation to the Reserve Bank of India. This will also lead to economy in the realization of assets and a speedy winding up of the concerns.

NOTE ON JOINT STOCK

By

M. L. TANNAN

The main object of this note is to invite attention only to such important points as require consideration for the improvement of commercial banks in this country. Accordingly, I have purposely omitted to give any historical sketch or a description of the existing commercial banking which the Secretary of the Sub-Committee may be requested to furnish.

The financing of Indian Commerce is mainly in the hands of Indian Joint Stock Banks, Exchange Banks, and the Imperial Bank of India. According to the Statistical Tables relating to Banks in India the volume of deposits of the said three classes of banks on 31st December, 1934, was as follows:—

Class of the Banks.	No. of H. O.	No. of Branches	Total Deposits in Crores of rupees.
1. Indian Joint Stock Banks, with capital and reserve of Rs. 1 Lakh or more.	105	688	81.88
2. Exchange Banks.*	—	98	—
3. The Imperial Bank of India.	3	160	90
Total	108	946	

*In the case of Exchange Banks only deposits with their Indian Offices are given.

In 1934 the total number of banking offices in India was 1269 against 25,000 in U.S.A., 13,200 in Great Britain and Ireland, 4,500 in France, 3,400 in Germany and 1,300 in Belgium. There was a banking office for every 276,000 persons in India as against 3,056; 4,816 and 9,491 in the United States, Great Britain and Japan, respectively. Even taking into account the important part played by the indigenous bankers it is generally conceded that there is ample scope for the expansion of the Joint Stock Banks in India. The absence of banking facilities coupled with the lack of education among the

masses must, therefore, lead to the age old habit of hoarding and temporary locking up of funds amounting to large sums which otherwise would be available for the development of credit facilities. Among the causes mainly responsible for the slow progress of joint stock banks in India attention may be invited particularly to the following:—

1. Indian Joint Stock Banks receive little or no encouragement from Government, Public, and semi-public bodies such as the municipalities, Port, Trusts, Courts of Wards, etc., which do not ordinarily deposit their funds with Indian Joint Stock Banks.

2. The **laissez faire** policy of the government in the matter of banking in India is partially responsible for the failure of some of the joint stock banks which has affected adversely the public confidence in Indian banks.

3. The Indian Joint Stock banks suffer from the competition of the exchange banks which not only monopolize the financing of external trade of this country but also take a large share in the financing of her internal trade with deposits received by their Indian offices. The Indian branches of 17 Exchange Banks working in this country had on 31st December, 1934, deposits amounting to Rs. 71.40 crores against 81.88 crores in the hands of 105 branches of Indian joint stock banks with a capital and reserve of rupees One Lakh or more. Moreover, complaints have sometimes been heard that not only do some exchange banks refuse to give proper replies to inquiries made by Indian banks regarding the credit-worthiness of some of the parties having previous dealings with those exchange banks but also to the effect that they run down certain Indian banks. The Indian joint stock banks have also suffered from the competition of the Imperial Bank of India due to its government support.

4. As a large measure of the trade and industries of this country is in the hands of the non-Indians, the Exchange Banks naturally receive preference over the Indian Banks.

5. The working of many Indian Banks suffers from many drawbacks, such as inefficient service, the absence from the Boards of Directors, of good businessmen and financiers having adequate business experience and good credit to inspire public confidence in those institutions, mutual jealousies and want of reliable agencies, cut-throat competition among Indian joint stock banks, locking up of large sums of money in landed properties, etc., etc.

Before considering the important steps to be taken to enable the Indian joint stock banks to play their proper part

in the financial organization of this country it will not be out of place to observe that the absence of a national government in this matter as in many others is bound to hamper the progress of Indian banking. It is but natural that in matters in which the interest of one's own country happen to clash with those of another, one is even unconsciously inclined to give preference to one's own country. It is, therefore, evident that the change in the government will automatically provide great encouragement to Indian banks. The following measures appear to be necessary for the development of Indian banking on sound lines in this country.

1. While on the one hand the government should provide the regulation of banking business by means of a comprehensive Bank Act* which will strengthen public confidence in Indian Banks, it should on the other give every encouragement by giving preference to good Indian banks in the matter of deposits of funds belonging to Port Trusts, Municipalities, Courts of Wards, educational and other institutions receiving government aid, granting of remittance concessions and exemptions from stamp duties and registration fees as given to the co-operative banks, extending facilities of borrowing money by equitable mortgages to large cities other than three Presidency Towns and Karachi and by removing defects in the existing laws regarding succession to and transfer of rights on immoveable property belonging to certain sections of Hindus and Mohammedans. Banking legislation should in itself not only protect the depositors and shareholders from unscrupulous banking management, but also secure the protection of banks themselves from unjust attacks on their stability, though the right of the public, the depositors and the shareholders to a fair criticism of the management must be carefully guarded.

2. In order to encourage Indian Joint Stock Banks to open new branches, the Reserve Bank of India should offer to deposit a certain amount with every new branch opened in a town without a commercial bank, by an approved joint stock bank with the previous consent of the Reserve Bank of India for a given period on such conditions as it may consider necessary to lay down and provide rediscounting facilities at special rates.

3. The Reserve Bank of India can further help the joint stock banks in this country in forming a Bankers' Association with the following objects:—

(a) to develop the practice of 'one man, one bank';

*Please see the note attached herewith.

(b) to arrange for the pooling of information regarding the credit of borrowers in different parts of the country and to create if necessary a special organization for the purpose;

(c) to create an **esprit de corps** among banks working in this country and to take suitable action in cases where some banks are found guilty of spreading false rumours about other banks.

(d) to encourage certain uniform practice in the best interests of the banks and the general public.

(e) to make representations to government, the Reserve Bank, and public or semi-public bodies and to take such steps as may be considered necessary in the general interests of banks working in this country.

4. The Reserve Bank of India should help the indigenous bankers, individually or in groups to form local banks, encourage the amalgamation of small banks, popularize the use of bills of exchange, increase the number of Bankers' Clearing Houses, and make suitable arrangements for the clearing of non-local cheques.

NOTE ON EXCHANGE BANKS

By

M. L. TANNAN

The British and other foreign banks working in India are known as the Exchange Banks because originally they entered into the Indian Banking field to finance foreign trade of this country. They occupy a very prominent position in the Indian money market. The banks have their head offices abroad. In the case of some of these banks such as the National Bank of India, Ltd., the Chartered Bank of India Ltd., and the Mercantile Bank of India, Ltd., a considerable portion of their business is carried on in this country, while in the case of others such as the Hong Kong Shanghai Banking Corporation, Ltd., the National City Bank of New York, The Yokohama Specie Bank Ltd., etc., only a comparatively small portion of their business is done in India. Not only these banks have more or less the monopoly of the foreign exchange business, but also they are formidable competitors of the Indian Joint Stock Banks in other fields of commercial banking in this country. At the end of 1934, these banks had no less than Rs. 71.40 crores of deposits in India, as against Rs. 81.88 crores held by all the Indian Joint Stock Banks. The present position of the Exchange Banks is due to the following factors:—

1. Some of them came into the field early and established their names.
2. As the foreign trade of India is largely in the hands of non-Indian business houses, they not only prefer to give their own business to such banks but also encourage other merchants to deal with them.
3. Not only have they been from time to time allowed to do their business in this country free from any restrictions generally imposed on foreign banks working in several other countries, but they have also received indirect help even from government in this country.
4. The efficiency of their management has also contributed to their present position.

There can be no two opinions as to the detrimental effects of the working of the Exchange Banks in this country. Not only do these banks make large profits at the expense of this

country, but they discourage Indian enterprise in several directions. For instance, they help foreign insurance and steamship companies, British merchants, brokers, solicitors, accountants, etc. These banks are said to be diverting Indian capital to investments in foreign industrial and gilt-edged securities. They do not usually give responsible posts to the nationals of this country. Complaints have some time been made that the staff of some of these banks run down some Indian Joint Stock Banks.

In order to remedy the present position, it appears necessary to take steps in the following two directions:—

1. to divert the financing of the foreign trade of India from foreign banks to an Indian Exchange Bank to be created for the purpose.
2. to impose such restrictions on the foreign banks working in this country as may be considered necessary in her best interests. Undoubtedly, there are difficulties in the way of transfer of the foreign exchange business of this country from the hands of strong and well established foreign banks to an Indian bank, but they are in no sense unsurmountable more particularly if the government and the people of this country make up their minds to do so. With this object an Indian Exchange Bank should be started with the backing of the Government and the Indian Joint Stock Banks. The Government can help by giving for the first seven years a guarantee of interest on the preference capital to be raised for the purpose. Any amount so paid by the government to be repaid gradually out of the surplus profits of the bank after setting aside amount required for payment of dividend at 3½%. Government should also undertake to contribute annually a certain sum not exceeding 50% of the annual expenses of the bank during the first five years. Other concessions such as exemption from the payment of income tax, certain stamp duties, etc., may also be granted to the proposed institution. The ordinary shares should in the first place be offered to the Indian Joint Stock Banks in some fixed proportion to their paid up capital and reserve fund. An alternative to the above scheme which may be considered is that the Imperial Bank of India should with the help of government and Indian Joint Stock Banks start a subsidiary institution for this purpose. Details of the scheme can be worked out after the preliminary discussions of the proposals by the Sub-Committee.

Before dealing with the restrictions to be imposed on the Exchange Banks, it is necessary to emphasize the fact that the policy of the open door to foreign banks in India should be discontinued as has been unanimously recommended by the Central Banking Committee. It is therefore, necessary to introduce the system of licensing the foreign banks operating in this country as is done in some other countries. In this connection attention is invited to my 'Regulation of Banks in India (pp. 26-27).

While it is true that as recommended in the majority report of the Central Banking Committee, licenses should be given freely to banks which have been operating in this country, it is submitted that due regard must be given to the promotion of the national economic policy in banking. In the first place no new foreign bank should be allowed to start business in this country without the previous permission of the Reserve Bank of India and such permission should be given only after satisfying among other things that the country of its origin imposes no undue restrictions upon the nationals of the country. The existing foreign banks also should be required to obtain such licenses though in their case the licensing authority may be more liberal than in the case of new banks. Secondly the Exchange Banks should restrict their activities to the Indian Port towns only. Thirdly, they must undertake to supply to the Reserve Bank of India full information about their working in India, and to throw open to Indians even responsible appointments except such as those of managers, assistant managers or chief accountants. Fourthly they should undertake to employ funds received in India in business in India or for investment in Indian securities.

NOTE ON SAVING AND INVESTMENT

By

PROF. K. T. SHAH

I

1. The essence of 'Saving' lies in the creation or bringing about of an excess of the total volume of production over the total requirements of consumption, both taken collectively.

2. In so far as the individualistic economy prevails in a community in regard to all productive processes, it is impossible to organise satisfactorily 'saving', and collect or mobilise the same in a central place. The process of distribution will then be conducted somehow, so that, while each individual member's requirements for consumption are fulfilled, or the needs for the entire process of production and the maintenance of national economy are supplied, a surplus is nevertheless brought about, which can be utilised either as reserve, or for further investment in any direction, in which it may be necessary to employ such surplus for furthering the process of production. There would be no co-ordinated or planned system of utilising such savings for the furtherance of the prevailing economy. It would be a wholly individualist affair, without any plan or system or method except such as may be provided by the desire for private gain.

3. One of the greatest needs for rehabilitating India's productive organisation is generally believed to be the lack of necessary 'capital', or the tools, materials and buildings for production and maintaining labour while the process is going on. This is due to the absence of sufficiently co-ordinated and mobilised 'saving', which can be readily invested for purposes where it may most be needed. Capital, however, is another form of the amount of national wealth saved, or mobilised, and kept together to serve for investment or use in any direction in which such capital is needed in the opinion of the Planning Authority.

4. This lack is caused mainly by the absolute insufficiency of the aggregate production of material goods and services in the country needed for the maintenance of a reasonable standard of living, of the most modest character, throughout the country. It is partly due also to the faults of the system of distribution in the country as also to the absence of a sense of political security until very recent times, and the backwardness of the methods and technique of production.

There is no dearth of initial endowment for producing new wealth in the country. But our resources remain unknown or untried; or, if they are exploited, they are so for the benefit of non-Indians mainly. For creating the necessary surplus needed for the maintenance of a planned economy, at the pitch and in the tempo decided upon by the Planning Authority, it would accordingly be necessary as much to speed up the process of production, improve its equipment in tools and machinery, and organise the technique of production to the best possible advantage, as to modernise and rationalise the methods and principles of distribution of the wealth produced, so as to bring about an equitable and more even distribution of the national wealth.

5. Apart from the collective insufficiency of the surplus needed for constituting 'saving' sufficient to serve as capital for an organised and planned productive system, there may, of course, be savings in individual instances, which, in their aggregate, may amount to a considerable amount. But this individual saving also need be conserved and organised, as well as mobilised so as to serve the purpose we have in view, namely intensification of the process of planned production, including modernisation of the instruments and technique of production and speeding up the tempo of the planned economy of this country.

6. At the present time, under the co-ordinated provisions of several pieces of legislation, it is incumbent on Joint Stock Companies engaged in any productive process, or in any service ancillary to production, to set apart a certain proportion of the excess of their receipts over outgoings to form a reserve. This reserve may take the shape of specific provision for depreciation and replacement of the machinery and other equipment required for production; or it may be a provision for maintaining a certain even rate of profits or dividends; or again it may simply be undistributed profits maintained as the first reserve of such a corporation.

The method of deliberately writing down the assets for purposes of preparing balance-sheets and profits and loss accounts will help to create such secret reserves. It is necessary that such legal provisions be made more stringent while the individualistic economy lasts, so as to make the maintenance of such reserves legally indispensable in all enterprises engaged in the process of production, whether in industry or agriculture, or in services ancillary to these processes, or in the so-called public utility works whose products or activities are capable of a commercial disposal.

7. The law must also provide for the instantaneous mobilisation of these reserves as soon as they are formed, and

require their maintenance in as liquid a form as possible. They must also be required to be deposited in some central institution charged with the control and utilisation of such resources of the community, so that even when the planned economy comes into operation, these reserves may be available for utilisation in any direction that the Planning Authority may decide upon.

8. The same applies to another class of reserves or 'savings' which are brought about by the Corporations or institutions engaged in Insurance business. The funds of these bodies are obviously of the nature of saving proper, set apart by the individuals doing so, and entrusted to the Corporations receiving them, with a view to protect the insured individuals against the particular contingencies insured against. The aggregate of these funds, after allowing for the losses or expenses payable out of these, would also need to be compulsorily mobilised, so that the total volume of the nation's savings, or capital available for further employment in productive direction may be increased.

9. The institutions definitely and specifically devoted to the collection of individual savings and their utilisation in the most economical manner, namely banks, have in this country conceived their mission in a somewhat restricted manner. Conventional banking is still regarded in this country as consisting of services to commerce, both internal and external, which admits of quick turnover, and, therefore, profits at a very low rate. Banking with a view to assist the productive process and organisation in the country, whether in industry or agriculture, needs yet to be created in this country on a national scale in proportion to the requirements of a planned economy. The existing land banks or mortgage banks or those concerned with agricultural co-operative credit, are all working on a very limited scale; and under considerable restriction it makes it impossible for them to aid substantially in the process of production. They deal mainly with small producers, concerned with operations on a very limited scale and whose margin of income is so small, that ordinarily no saving is possible in their case on their own books.

10. In addition, there is the constant fear and overwhelming weight of Indebtedness, which besets the agriculturist and small scale producer in rural districts. Almost the entire volume of this debt is of an unproductive character, and acts as a deadweight upon the national economy. One of the first steps indispensable for the proper execution of the Plan, would accordingly have to be a compulsory registration of the amount and conditions of agricultural indebtedness, under which the Indian agriculturist and countryside producer has

to labour, to the immense disadvantage of himself as well as the country. These debts carry an incredibly and unconscionably high rate of interest which further reduces the potential margin of saving of the agriculturist and other small producer. Any process which aims at affording real, substantial and permanent relief to the indebted agriculturist would accordingly have to bring about a compulsory reduction of the rate of interest and modification of the other onerous terms connected with this debt. A special type of institution would accordingly have to be evolved and set up to deal with collection, registration and liquidation of the agriculturists' debts. The saving thus afforded would have to be utilised to create new reserves so as to aid in the process of production.

11. The savings thus brought about and mobilised from our resources will be useless unless the basis of investment and the directions for the same including the time and amount of such investment are also provided by the Planning Authority in accordance with the requirements of planned economy. If and when such savings prove inadequate,—as may quite possibly be the case for the requirements of India's planned economy in the next ten years,—it may be necessary to attract capital from abroad, on terms and under conditions which may be supportable by Indian enterprise. But, any capital thus attracted from abroad must also be under the direction of the Central National Banking Institution, so that the foreign capitalist should not exact a disproportionate toll from India's national economy because of the loan of his capital.

II

The total volume of savings available in this country, even as known at present, is difficult to compute exactly. The statistics of banks and banking in India indicate the total volume of deposits as follows:

In the Reserve Bank of India from Govt. Sources:	(about)	Rs. 11 crores.	(31-12-'38)
Other deposits from Banks:	„	Rs. 13 crores.	
In the Exchange Banks:	„	Rs. 75 crores.	
In the Joint Stock Banks:	„	Rs. 98 crores.	
In the Post Office Savings Banks there were about	„	Rs. 77.5 „	(31- 3-'38)
Deposits in the Postal Life Insurance System — an aggregate of 96 thousand policies valued at nearly		Rs. 19.0 „	
Total		Rs. 293.5	

These do not exhaust the amounts which may be said to be representing savings in a fairly mobilised form. The various reserve funds in charge of the Government or of the Banks, including the Currency Reserve, public Joint Stock Companies, which are required by law to maintain a 'Reserve', and the funds of the Life Insurance Concerns, not to mention treasury balances, may also be included in computing the total volume of savings available in India.

Not all of these, of course, can be regarded as wholly available for purposes of industrial investment, or economic development of the country, much less for social services. But even if we regard half of these funds only as available for this purpose, we might find it would go a long way to meet the requirements of a carefully compiled Plan of National Economy. Such a Plan must lay down the order in which the progress of economic development in the country is to be achieved; which task of industrial as well as agricultural development would have to take precedents over others of the same species; what social services would need to be developed side by side, so as progressively to improve the standard of life among the people, etc. The capital that may then be required would not be impossible to meet from India's own known, or unknown, resources.

The aggregate of the known resources mentioned above, comes to 290 crores in round terms. Half of this amount may quite possibly suffice for the capital needs of a Progressive Plan, of national development and social reconstruction. On this basis it would lay our hands on at least Rs. 15 crores per annum for use as capital needed for the Plan every year for ten years,—the first instalment of the national programme, i.e., about 150 crores in all. Such investment, it must not be overlooked, will itself help to bring about new capital by producing a new surplus of production over consumption, and so the resources would be progressively improving.

In addition to these, there are secret and unknown resources which lie practically buried in the religious foundations, charitable trusts, temples, mosques, churches and so on, which are impossible to be used at the present time for purposes of the economic regeneration of the country, and the carrying out of a proper plan of national economy. Popular sentiment would need to be educated much more thoroughly on rationalistic lines to permit of such diversion of these funds. It is impossible to estimate the volume of liquid resources locked in such unproductive and unusable channels. They have been accumulating ceaselessly for centuries. A rough

estimate of these potential reserves seems to indicate that perhaps all the needs by way of capital for the industrial development of the country may be obtained from these sources alone, so that India may not have to go out and borrow abroad for this essential purpose of national life.

The volume of capital investment required for purposes of a progressive Ten-Year National Plan is likewise difficult to estimate exactly. Various estimates have, in fact, been made, which would indicate that the total capital investment of about 400 crores judiciously laid out would make this country not only self-sufficient in all matters of essential requirements but would also assure it a degree of prosperity and improvement in the standard of life amongst the vast masses of its population which would be well within the requirements prescribed by the National Planning Committee. The reports of the Manufacturing Industries Sub-Committee, of the Chemical Industries Sub-Committee, Engineering Industries, and other industrial and agricultural committees have yet to be submitted. They would put forward their own estimates and requirements of capital needed for the purpose of carrying out their section of the Plan of national economy; and these co-ordinated would constitute the aggregate sum needed for this purpose. Pending receipt and co-ordination of these, our recommendation must needs be tentative, or only illustrative. But the figures we have put forward above would go a long way to show, we trust, that the capital needs of India in respect of a Plan are not impossible to meet from her own resources.

It must also be remembered that all the capital required will not be wanted at once on the same day. The Plan itself is necessarily progressive, and its realisation developing year after year, so that, within the first instalment of the Plan proposed,—for ten years,—we would need, at a progressive rate, capital for investment in industrial and other economic development of the country perhaps not exceeding 20 crores a year. 20 crores per annum is not too much to expect from Indian resources alone even in normal times as the experience of the Government of India in floating loans for their relatively non-productive purposes over the last thirty years will show.

N.B.—Heads of Enquiry No. 10 and No. 11 are not submitted by the respective contributors.

NOTE ON GOVERNMENT BORROWING

By

MANU SUBEDAR

There has been a check on Government borrowing for railway purposes ever since railway finance showed adverse results. The following table will indicate:—

Year.		Net revenue.	Interest charges.	Surplus.	Total Rly. deby.
		(Figures in crores of rupees)			
1926/27	..	33.37	25.87	7.50	655.71
1927/28	..	38.12	27.27	10.85	668.59
1928/29	..	37.14	29.33	7.81	700.69
1929/30	..	34.50	30.46	4.04	730.79
1930/31	..	27.53	32.72	—5.19	743.98
1931/32	..	23.87	33.07	—9.20	750.72
1932/33	..	22.68	32.91	—10.23	750.75
1933/34	..	24.62	32.58	—7.96	754.94
1934/35	..	26.74	31.80	—5.06	755.63
1935/36	..	27.39	31.39	—4.00	750.04

It will be noted that a larger amount of borrowing came for Provincial Governments. In Government of India's finance, this is put down as productive, because the interest charges are borne by the provinces. In so far as the provinces are solvent, the interest will undoubtedly be paid, but, in the affairs of many provinces, much money, which has been raised, has been frozen. In some cases the capital would have to be written off. The most outstanding example is the Development Expenditure of the Government of Bombay.

It is obvious that, since the last war, Government borrowings is playing a much more important role than it did before. In other words, Government are taking up a lot of capital both for long-term investment as well as for short-term loans. This means that Government are competing with industry and commerce for money and, with the credit of the state, which is always superior to that of any private enterprise or individual, Government are in a position to have the pick.

What would happen if Government came for a much larger amount? To what extent can Government still increase their borrowings without sending up money rates, or without materially curtailing the resources available to trade and

industry? These questions require careful thought. There is not available at any time more than a limited quantity of loanable capital. There is some capital, which is awaiting long-term investment and which, while the decision is pending and while the accumulation is going on, is put in Treasury Bills or short-term deposits. There is some money, which must be put out on short period, such as current funds with banks, which are liable to be recalled at any moment, but the investments in Treasury Bills and other short-term Papers, would go on at the hands of the banks, if the funds are not so recalled.

The amount of money awaiting disposal has increased in India on account of new types of business having come into existence. The growth of joint stock enterprise, for example, involves the making up of accounts once in the year and the disposal of the profits, which accrue every month, occurs only after the accounts are prepared and few months after the close of the year. The growth of the banking habit is also responsible for the break-up of the so-called private hoards or cash, which were kept by money-lenders and by shroffs all over the country. Much of this money finds its way into the banks now in current account. While the resources of the banks in this manner have increased for immediate investment on the one hand, Government have taken up a lot of these on Treasury Bills and short-term borrowing. There has not been, therefore, an increase of money rates and there will not be, so long as the demand is not in excess of the supply.

Another direction, from which the increased borrowings of Government in recent years have been satisfied, is the investment of life insurance companies. The law now rigidly compels them to put their premium reserves in Government loans or Trustee securities. Automatically, as the business of insurance grows in India, large funds are released for this purpose and are absorbed by an increasing amount of capital taken off by Government from the market. Had Government not increased their loans, these funds would have driven the money rates down in India.

The artificial reduction of bank rate in India following slavishly the policy in the United Kingdom, has had serious consequences. A 3% bank rate does not reflect the millions of transactions of loanable capital, which are done all over the country between borrowers and lenders. But a 3% bank rate has the effect of reducing the deposit rates by banks. At the expense of the depositors, therefore, the banks have made money. The reduction of rates offered by banks to depositors had also the effect of driving some of this money into the field

of Government loans. This artificial stimulus to investment in Government security cannot last, and the whole problem of money rates in India will have to be settled, so as to reflect more correctly the economic conditions than has been done hitherto.

The advent of popular Ministries has compelled popular Governments to come on the market and though there is, as there ought to be, a salutary regulation that they will not compete with one another, or make a scramble for money, the borrowings of popular Governments on Treasury Bills have been at a higher rate than the borrowings of the Central Government for Treasury Bills. Similarly, in long-period loans, there has been a difference of not less than half per cent—but in some cases as much as one per cent—between the borrowing of the Central Government and that of the Provincial Governments. This is a disadvantage to India as a whole, as it imposes a larger burden on the tax-payer, who is the same party both for the provinces and for the Centre. By a reorganization, this extra interest, which is being paid out, could be saved.

The volume of borrowings having increased, the tendency for slightly increased rates, in the first instance in the provinces, has manifested itself. This must go on, as the volume of borrowing is added to, as indeed it must be in fulfilment of the demand for capital for many objects, which have been sponsored and proclaimed by the Provincial Governments. Much care would be required in order to see that the total volume called for at any time is not in excess of the total volume available. Further care would be required to see that important objects in some places are not hung up, whereas relatively less important objects secure the money which is available. The care is required also to prevent the rates, at which borrowing takes place, from rising unduly.

The following table will show how the borrowing rates for the Government of India went up to as much as 7½ per cent on Treasury Bills and to 6 per cent on long-period bonds, because of the lack of care and because the pressure for Government loans was very much greater than what the market could supply:

July, 1922	6% free of income-tax issued at par.
July, 1924	5% 1933 Bonds, free of tax, issued at 94/4/0, giving a yield of 5.247% and 5% 1945/55, free of tax, issued at 99/-; yield of 5.079%.

July, 1925	No new loan, but there only a conversion loan on varying terms for loans maturing at different dates.
May/June, 1926	4% Loan 1960/70—tax bearing—issue price 88%. Yield 4¾%.
July, 1927	4% tax bearing; issue price 94/8; repayable 1st August, 1937—giving a yield of nearly 5%.
August, 1928	Two rupee loans giving a yield of 4.87% and 4.99%.
June, 1929	Two loans. Yield of 5.459% and 5.395% respectively.
July, 1930	6% tax-bearing.
December, 1931	6½% tax-bearing.
June, 1932	5½% tax-bearing.
August, 1932	5% tax-bearing.
January, 1933	4% tax-bearing.
February, 1933	4% conversion.

Treasury Bills Discount Rate

April, 1922	Rs. 4/14/- per cent.
April, 1924	Treasury Bills not sold during the year.
April, 1925	—do—
April, 1926	—do—
April, 1926	—do—
August, 1927	Rs. 4/1/6 per cent.
March, 1928	Rs. 4/9/6 do.
March, 1930	Rs. 6/0/0 do.
March, 1931	6.42% yield.
September, 1931	7.38% do.
September 1932	6.00% do.
September, 1933	2.6% (maximum yield during the year).'

The competition offered by trade and industry is of great importance. The relative safety offered by Government borrowing may be higher. But the yield of debentures of a first-class industrial enterprise gives a security, which has only a notional inferiority, but which, for practical purposes, is extremely good. Where industry is, therefore, prosperous and is able to offer adequate security and to borrow at high rates, the state would either have to curtail its demand, or to pay higher rates itself. An excessive emphasis on state borrowing for all and sundry purposes must be avoided, because of the harmful effect on the enterprise of the community through

the depletion of capital and its diversion into relatively unproductive channels.

The idea, that capital in the hands of the state can do more useful work than capital in the hands of the private individual, must be abandoned, and it is necessary to emphasize this in view of large and unlimited programmes of socialisation and nationalisation, which are in the air. Whatever is taken out at one end, must necessarily have effect at the other end, and a very deleterious effect at that. Those, who entertain the belief that private enterprise will still go on with the same efficiency and produce the same amount of commodities and utilities, as it is producing now—no matter what the state might do and how much capital the state might carry away from the market—must be prepared for a rather rude shock and disillusionment. The market for capital is extremely sensitive and registers its reaction to every event in the world and to the announcement of every change or intention on the part of Government authorities. Great harm could be done to enterprises generally by an unwise and untimely statement of Government policy. We have the illustration in the speech of the Finance Member, Mr. Latthe, when he assumed office. With perfectly good intentions, he referred to enterprises for the generation of electricity and for its distribution to consumers, as sources from which he would draw money. While he was not ready with any programme at the moment when he spoke, and while his subsequent programme for taking money from these directions was extremely moderate, the effect of his statement was disastrous. Not only did it prevent further money going into these enterprises, but it depreciated to the extent of several crores the holdings of the people in these enterprises. Responsible persons handling the subject of Government borrowing must, therefore, put a very strong check on the words which they use. Any announcement of large and expensive programmes, involving large Government borrowing, would, even if such programmes had never materialised, have a very disturbing effect on the capital market.

NOTE ON INVESTMENT TRUSTS

By
MANU SUBEDAR

I

An investment trust company is a company, which has put forward as its object the investment of the company's capital and/or borrowings in a specific form, so as to create a trust between the company and the shareholder by the undertaking of the assurance given or conveyed in this manner.

The advantage of an investment trust is obvious. When an individual goes to the market to find an investment for his moneys in the form of securities of his own Government or of local and statutory bodies, or of foreign Governments, or of shares of companies operating in his own country or abroad, he does not go even with the necessary detailed knowledge to be able to select the investments, which would give him a safe return. For one thing, the resources of an individual are not large enough to spread out the investment, so as to secure against the rise or fall in the market. This rhythm of the market is seasonal in many countries and there is also a rhythm extending over a period of years, which may be eight, nine, ten, or fourteen years, differing at different times and in different countries in the world. In this rhythm it is found that, when securities with a fixed yield are going down in value, the equities are going up in value, and 'vice versa'. This phenomenon is well known and many attempts have been made to explain it on psychological and other grounds. The vicissitudes of the market are understood by some individuals, but not by all investors. Even when they are understood by an individual, he is not always able to guard himself against the risk of capital fluctuation, because of his limited resources. It is, therefore, through an investment trust that close knowledge of market conditions is secured and that, by a sufficient spread of securities in many directions, the investor safeguards himself to some extent against changes in their characters. It is not merely in point of time and yield that the securities are varied, but also with reference to industries. Certain industries develop a crisis and, if all one's resources were put in those industries, the crisis would engulf those resources. But an acute depression does not occur simultaneously in all industries, nor again in all countries, and when such a depression does occur, the excess available funds for investment necessarily flow towards more secured investments, viz. Government

loans, which therefore appreciate. It is through the instrument of the 'investment trust' that a small investor can, to some extent, guard himself against his capital being seriously depleted through these fluctuations.

In some cases the investment trust declares what investments it will confine itself to. In other cases the powers are given to the directors. The development of investment trust has been more serious in America than in England, and more serious in England than in India. Investment trusts as an intermediary body between the primary investor and the market can play a very important role not merely with reference to the primary investor, but with reference to the market. The instrument of machinery is also capable of being abused in the hands of unscrupulous men, who could use the financial powers of trust companies for rigging the market in their own favour, for depreciating certain shares and for appreciating them as and when it suits their private ends. The abuse is clearly an abuse of trust funds by trustees and the law must necessarily provide for a check against such abuses.

Once the investor buys shares in an investment trust company, he is tied to it. It may be that these shares are not freely marketable. It may be that it is not open to him to sell these shares outside, but they must be offered, when he wants to sell, to the other members of the company. Sometimes these other members of the company operate collectively through the company to buy out units, which come on the market and, either extinguish them, or put them forth again in a perpetual movement of new capital coming in and old capital going out. This also has given a variety of forms to the mechanism of the investment trust company.

The greatest deterrent to the growth of investment trusts has been the liability of shareholders of these companies to super-tax a second time, i.e. even if the super-tax has been already paid by the company itself. The liability to income-tax was also there.

II

1. Pending the institution of a National Central Organisation to absorb savings and direct investments of all such savings in the enterprise under the Plan, it would be desirable to institute a Special Investment Trust for the whole country, with branches or affiliations in each Province or component unit, to absorb every saving of the people and to invest them in enterprise conducted by, or under the authority of the National Planning Authority.

2. The constitution, powers and functions of this body, together with the principles of the absorption when the time

is ripe for the purpose in a Central Investment Board for the country, should be laid down as part of the general Plan. The terms and conditions under which such investment should be made by this statutory authority must also be prescribed in general by the instrument establishing such a Trust.

3. The management of the investments, their realisation, and change from time to time at the instance of the holder or for other reasons, must be regulated by the Bye-laws of the body itself made under the general authority given in that behalf.

4. Every facility should be given to the popularity and expansion of the operations of such a Trust, e.g. in the form of eliminating the liability of the individual investor for super-tax, so as to enable the Trust to make its operations as nation-wide as possible.

5. The Trust should be closely inter-connected and work in close co-operation with the Central Monetary Institution, whatever that may be, of the country.

Agricultural Credit

1. The principal handicap to the full utilisation of credit by agriculturists lies in the heavy existing load of indebtedness.

Relief of indebtedness may be achieved by the State taking over all debts and repaying the creditors on terms specifically settled in accordance with the general law passed in that behalf.

2. Methods of Debt conciliation, fixing of interest to a maximum rate as well as to the maximum aggregate payable on any loan are likely to be only palliatives, without remedying the evil radically.

3. Any system of debt relief to agriculturists must be conducted by the Local Banks, working in close co-operation with the Central Monetary Organisation of the country.

4. Borrowing by Governments in India should be restricted, as far as possible, to the Indian Money Market. It is desirable to conduct borrowing of every kind of Governmental authority by the Central Monetary and Credit Institution of the country.

5. Except for the Central Government of the country, no borrowing by any public authority should be allowed,—whether a Provincial Government, Municipality, a District

Board, or any other Statutory Corporation except for productive purposes, these purposes being defined carefully and definitely in advance, as involving some advantage within a prescribed period to the total national wealth of the country.

6. Even for the National Government of the country, borrowing should be restricted only to productive purposes, except in case of such an emergency like an earthquake, a famine or a flood, or for purposes of defending the country. In all other cases of borrowing by the Central National Government, productivity of the enterprise or service, proposed to be financed by such borrowed money, should be the first consideration and should be capable of verification within a prescribed number of years, say Five or at most Ten, so that, within that period, the full load of interest and a 'pro rata' amount for repayment of capital would be forthcoming from the surplus of the proceeds of such enterprise or service.

7. Short term borrowing by the Central National Government may be permitted under definite conditions and restrictions, so as not to unduly starve the Money Market of the country, for purposes of investment in industry or commerce.

8. Modes of short term borrowing by Government, as exemplified by the Treasury Bills, may be convenient for such institutions, as Banks or other bodies wishing to employ any part of their current funds so as to prevent these funds remaining idle. To Government, it would also be an advantage for meeting current needs, when the reserves have not been released in the same proportion as the needs arise.

9. Any borrowing in the shape of Post Office Savings Bank Deposit or Cash Certificates should be minimised, as much as possible. All Government borrowings hitherto should be consolidated in a Central Funds Account for facility of management and convenience of investment.

10. Earliest opportunity should be taken to repay outstanding indebtedness owing to creditors abroad and replace by corresponding investment of indigenous funds.

11. Funds of Life Insurance Companies and other similar institutions should be centralised and co-ordinated, so as to provide a larger nucleus for investment, mainly in enterprise under the National Planning Authority.

12. Bank Rate in India must be kept as low as possible. Fluctuations in Bank Rate should not be very considerable, Operations of the Central Monetary Authority in the country

in the ordinary Money Market must be so conducted as to minimise fluctuations in the Bank Rate and keep it as low as possible.

13. Scope for borrowing in the era of Planned Economy will be very considerably increased and care will have to be taken so to organise borrowing as to assure due and regular repayment of both capital and interest.

14. Undertaking of large scale public works out of borrowed capitals, as a means of solving unemployment amongst other things, should be kept as an objective in view by Government, and should be carried on wherever and whenever the facility for the purpose is available.

DRAFT MEMORANDUM ON LAND MORTGAGE BANKS

By

PROF. C. N. VAKIL

Land Mortgage Banks

The following note is based on the working of the Land Mortgage Banks in Bombay Presidency. The progress of these Banks in Madras is greater. Though details about other Provinces could not be obtained at short notice, the general experience may be taken to be the same throughout the country, and the consideration of the main problem will not therefore be affected.

Early History

Government first approved of a scheme for establishment of Land Mortgage Banks in 1927. By 1929, three primary land mortgage banks, one in each of the three linguistic divisions of the Presidency, were registered.

1. The main features of the scheme were:—

(1) The Banks were financed by the Bombay Provincial Co-operative Bank through their Land Mortgage Branch Department.

(2) Government purchased debentures issued by the Bombay Provincial Co-operative Bank worth Rs. 2 lakhs at 88% carrying 4% interest.

(3) The services of a Land Valuation Officer was provided for one year, free of cost to each Bank.

2. In the case of two Banks the area of operations extended to the whole of the District, while in one Bank it was restricted to a Taluka only. Every loan was finally sanctioned by the Bombay Provincial Co-operative Bank and the Registrar. The limit of individual finance was fixed at Rs. 10,000/-. Membership was restricted to borrowers only, but intending borrowers could join.

3. The bulk of the loans advanced was for redemption of old debts and in a few cases only, for installation of costly machinery and for improvement of land. A margin of two per cent was kept between the borrowing and lending rates by the Provincial Bank and the Primary Banks which worked

as agents of the Provincial Bank were given grants by the former to meet expenses.

4. The Board of Directors consisted of not less than seven members of whom one was the nominee of the Registrar, one of the Bombay Provincial Co-operative Bank and one elected by the Debenture holders residing in the area of operations of the Bank.

5. In 1935 after a review of the existing position by the Land Mortgage Committee appointed by Government it was decided to start ten new primary land mortgage banks which were registered in June, 1935. It was decided that the Provincial Co-operative Bank should not undertake the business of financing the Land Mortgage Banks for the following reasons:—

(i) The Bombay Provincial Co-operative Bank works mainly on short term deposits and utilisation of part of its funds for long term investments is likely to react on its credit.

(ii) Long term credit is a special type of business and requires distinctive handling and expert staff. An apex Bank called "the Bombay Provincial Co-operative Land Mortgage Bank" was, therefore, registered in December, 1935 to finance Primary Land Mortgage Banks.

6. The old Banks were advised to adopt revised bye-laws suggested for the new Banks and to apply for fresh loans to the Provincial Co-operative Land Mortgage Bank. The question of transfer of assets and liabilities of the Land Mortgage Branch of the Bombay Provincial Co-operative Bank to the Bombay Provincial Co-operative Land Mortgage Bank is under consideration.

Primary Land Mortgage Banks

7. The salient features of the new scheme are given below:—

(a) The area of operations of a Primary Bank is restricted to a revenue district. Only in two districts where special conditions for development exist, the area of operation is less than a district.

(b) Both borrowers and non-borrowers are allowed to be members. Provision for admission of non-borrowing members has been made with a view to enable the Banks to enlist the services of influential and public spirited men for efficient management of the Banks. Co-partners and persons

interested in the property of the borrowing members are also admitted as 'B' class members, without any right to vote.

(c) Funds are raised (i) by issue of shares, (ii), entrance fees and other fees and charges, (iii) loans from Provincial Land Mortgage Banks.

(d) With a view to secure careful and business-like management, certain safeguards have been adopted. The bye-laws provide for the nomination of Directors by the Registrar for the first three years. The bye-laws also, provide for the sanction of the Registrar for all loans from the Provincial to Primary Banks and from Primary Banks to individuals in the initial stages.

(e) Primary Banks employ Land Valuation Officers, who are lent hands from the Department. In order to meet a part of the cost of these officers, Governments give a cash subsidy of Rs. 5,000/- per annum, for the first three years to be distributed equally between the ten new Banks.

(f) **Procedure for sanction of loan applications.**

On receipt of an application by a primary bank, the Manager first decides the 'prima facie' eligibility of the application. The Land Valuation Officer, then inspects the lands and submits his report regarding their evaluation in respect of market value, yielding capacity and rental value, legal title, and extent and nature of each person's interest in them. The papers are forwarded to the legal adviser, who certifies as regards the marketable title of the applicant to the lands proposed to be mortgaged to the Banks. After obtaining the sanction of the Board, it is forwarded to the Provincial Land Mortgage Bank through the Assistant Registrar for Land Mortgage Banks, who is an officer of the Department. When the Provincial Land Mortgage Bank sanctions the loan it communicates the loan sanction through the Assistant Registrar for Land Mortgage Banks to the Primary Land Mortgage Bank. In case of loans for redemption of old debts conciliation is tried through a board constituted for the purpose for each taluka. On completion of all requirements the loan is disbursed by the Primary Bank by obtaining funds from the Provincial Bank.

(i) Besides redemption of old debts, loans are also granted for (1) Improvement of lands, (2) Purchase of costly agricultural plant, (3) Purchase of land for more economic cultivation of the existing land.

(ii) The maximum and minimum limits for loans have been fixed at Rs. 10,000/- and Rs. 400/- respectively. With the special sanction of the Rgeistrar, the maxi-

mum limit is allowed to be exceeded. Immovable property of the value of at least twice the loan granted is taken as mortgage by the Bank with or without possession.

(iii) The mortgaged property will be revalued once in three years so that if there is any diminution in the security the borrower can be asked to make good, the deficit of the loan may be recovered at once.

(iv) The borrower is at liberty to repay the loans either in equal annual instalments of principal, interest being calculated on the amount outstanding, or by equated annual instalments including principal and interest, which in either case are not to be spread over a period exceeding 20 years.

(v) The rate of interest on loans is not to exceed $1\frac{1}{2}\%$ over the rate charged by the Provincial Land Mortgage Bank. The present rate charged to borrowers is 6%. This is liable to change according to changes in the money market.

A Note on the Working of the Provincial Co-operative Land Mortgage Bank

8. In pursuance of the recommendations of the Land Mortgage Banks Committee appointed by Government, the Provincial Land Mortgage Bank was registered in December, 1935. Its object is primarily to finance Land Mortgage Banks. Membership is open both to individuals and Primary Land Mortgage Banks. The capital of the Bank is Rs. 10 lakhs made up of 10,000 shares of Rs. 100/- each. The administration of the affairs of the Bank rests in a Board consisting of 15 members. The Registrar, Co-operative Societies, who is the trustee for the Bank is an ex-officio member of the Board. Of the remaining 14 members 5 are representatives of individual members and 2 are nominated by the Registrar with the previous approval of Government. One is nominated by the Provincial Co-operative Bank and one is the Managing Director of the Provincial Land Mortgage Bank. The Board may delegate all or any of its powers to the executive committee consisting of 6 members. The Provincial Land Mortgage Bank raises funds mainly by the floatation of debentures up to 25 times its paid-up share capital and reserve fund. Under the bye-laws of the Provincial Co-operative Land Mortgage Bank, the Board of the Bank may with the permission of the Registrar as trustee issue debentures of one or more denominations for such periods as it may deem expedient on the security of

mortgages and other assets transferred by Primary Land Mortgage Banks to the Provincial Land Mortgage Bank and of other properties of the Bank. The total amount due on the debentures shall not exceed the total amount due on the mortgages, the amounts paid thereunder and remaining in the hands of the Board or of the trustee. Government has guaranteed fully and unconditionally the principal of and the interest on the debentures of Rs. 20 lakhs so far. The mutual obligations and rights of the Government, the trustee and the debenture holders have been embodied in a document called the Debenture Trust Deed which is executed by the Provincial Land Mortgage Bank.

9. The first issue of debentures amounting to 20 lakhs was floated last year at 3¾% per annum. The debentures worth about 16 lakhs out of 20 lakhs were purchased by the Public and the remaining were purchased by Government. The debentures are irredeemable for a period of 20 years. The Bank is required to maintain Sinking Fund Account in which annual payments are to be made in order that the debentures could be redeemed at the date of maturity from the collections put into Sinking Fund.

10. Government have given every possible support to make the debentures of the Bank attractive to the investing public. Indian Trusts Act have been amended suitably so as to include the debentures as trustee securities. The duty chargeable under the Indian Stamp Act on the deeds of transfer in respect of the debentures of the Bank has been remitted.

11. One fourth of the net profits of the Provincial Land Mortgage Bank, every year shall be carried to the Reserve Fund. The balance is available for distribution of dividend not exceeding 6 per cent per annum.

Concessions Given by Government

12. In addition to the concessions given to the Primary and Provincial Land Mortgage Banks stated here-to-fore, Government have also given the following facilities:—

(a) Officers of the Land Mortgage Banks are allowed to have a search into the registration records free of charge.

(b) Village records are also open for inspection by an officer of a land mortgage bank.

(c) One Mamlatdar in each District where a Land Mortgage Bank is working is allowed to work with the Board of Conciliation set up by a Primary Bank so that with his influ-

ence, obdurate creditors are brought round and the work of the Board is facilitated.

(d) Government have also agreed to forego the leave and pension contributions of the Land Valuation Officers who are lent hands of the Department.

(e) Government have given a free grant of Rs. 500/- to each of the ten Primary Land Mortgage Banks registered in 1935 and a free grant of Rs. 10,000/- to the Provincial Land Mortgage Bank in the first year and further grants to make good the deficits in the next two years.

13. The technique of Land Mortgage Banking is difficult and complicated. The object of the Land Mortgage Bank is to provide long term credit on easy terms to agriculturists on security of agricultural land. For providing this credit an elaborate machinery has been considered to be necessary. In order to be eligible for this credit, the borrower has to fulfil 3 essential conditions:—

1. He must be able to offer as security for the loan, lands worth at least twice the amount of the loan.
2. The title to the lands should be clear and marketable.
3. There must be adequate repaying capacity i.e. to say sufficient margin of profit after meeting all the current expenses both domestic and agricultural.

The responsibility for making the scrutiny of loan applications, with a view to ascertain whether the conditions are fulfilled is laid upon the Primary Banks. The scrutiny of loan applications calls for high standard of judgment and experience and insight on the part of persons who are to estimate the value of lands and repaying capacity, etc. Though in theory the Directors of the Bank who are elected by the shareholders are supposed to bring their knowledge of local conditions to bear upon the examination of the loan applications, in actual practice it is found that they depend upon the recommendations of the paid staff of the Bank. So, much depends upon the calibre and efficiency of the Land Valuation Officer employed by the Bank. The number of applications rejected on the ground that one or more of the conditions are not fulfilled by the applicants, is very large, forming nearly 60 to 70 per cent of the applications. The procedure prescribed for disposal of loan applications is rather dilatory, partly due to the fact that the borrowers themselves are not able to supply all the information about their debts, income, lands, etc. promptly and correctly, and partly due to the fact that inquiries are

required to be made in a number of details. Investigation into the title of the applicant for land is one of the major causes of delay, for, law regarding property is very complicated. If it were possible to devise some method by which the title for land could be verified easily, the work of the Banks will be facilitated and speeded up.

14. It is incumbent upon the Banks to conciliate the debts proposed to be redeemed by a loan from the Bank by negotiations with the creditors, as the Banks have no power to compel the creditors to disclose the true state of accounts or to reduce the debts. The conciliation at present is on a voluntary basis, and not very effective.

15. One of the problems in connection with the Land Mortgage Banks, is how to provide for the shorter requirements of the borrowers, whose credit in the market is practically nil as their property is mortgaged to the Land Mortgage Banks. No satisfactory solution has been found in this respect.

16. It is necessary for the borrowers who have taken loans from the Land Mortgage Banks to pay off the dues of Sowkars to practice thrift in order that they would be in a position to repay the instalments of the loan regularly. They should take care to see that they do not get into debt again. The success of the Land Mortgage Banks depends on the extent to which the borrowers have improved their economic conditions by their industry and thrift after *their free lead* from the debts.

The following issues arise from the above survey:—

(1) In what way can the resources of the Land Mortgage Bank be increased?

(2) Is it possible to reduce the rate of interest at which the Bank lends?

(3) In what way can the current needs of a farmer who has mortgaged his lands to the Bank be met?

(4) Is it possible to simplify the procedure by which loans are granted?

(5) To what extent should Government assistance and control be increased or decreased?

(6) Are any changes necessary in the administration of the Bank?

NOTE ON POSTAL BANKING

By

PROF. K. T. SHAH

The Post Office in India conducts a Banking Department, almost entirely devoted to the Savings Bank Business only. The volume of the business available for this Bank is indicated in the following statistics:—

A. Post Office Savings Bank.

(In Lakhs of Rupees)

Year.	Deposits.	Withdrawals.	Amount outstanding.
1930-31 ..	24,36	25,50	37,02
1934-35 ..	38,67	37,26	58,30
1939-40 ..	40,51	45,22	78,32
1940-41 ..	25,35	45,09	59,51
1941-42 ..	21,91	30,18	52,07
1942-43 ..	22,26	22,84	52,22
1943-44 ..	35,22	24,19	64,18
1944-45 ..	43,76	28,94	80,22
1945-46 ..	74,42	41,30	1,15,04
1946-47 ..	91,68	64,37	1,42,35
1947-48* (Preliminary 1st April to 14th August.) ..	37,45	33,66	1,46,14

Source: Report on Currency & Finance 1947-48, p.153.

(In Lakhs of Rupees.)

B.*The Total of Amount outstanding in the Post Office

	Cash Certificates was	37,75
,, ,, ,,	**Defence Savings** was	5,18
,, ,, ,,	**National Savings** was	74,95
,, ,, ,,	**Defence Savings Bank** was	6,03

*(For the year 1947-48 preliminary 1st April to 14th August.)

Source: Report on Currency and Finance, 1947-48, p. 152-153.

The conditions for which the accounts of the Post Office Savings Bank can be maintained and the restrictions of the volumes to be held therein, as well as for purposes of operation, are so considerable that the utility of this system is very considerably limited. The handicap also on the small trader, having occasion to remit from place to place through the agency of the post office is disproportionate to all reasons of cost or service. And it becomes particularly undesirable when one finds in contrast that remittances within the country of large sums are carried out at relatively very little cost. It seems to be an axiom of sound banking arrangements within a country that all charges for internal remittance should be abolished. In India also, it is not impossible to attain this objective, though even in regard to large remittances for commercial purposes, the retention of a charge is not unknown.

If the Postal Banks work in concert with the Reserve or the Imperial Bank of India, and were to be reorganised in such a manner that no actual transfer of specie or currency need take place but amounts may be credited or debited in the different postal centres from where and to which such remittances are made, the utility of the Postal Bank would be very largely increased and its popularity enhanced in proportion. A new negotiable instrument, or a new form of non-legal tender currency, may be invented to serve as the Postal Cheque,—something like the present day Postal Order, though issuable and available at very little, if any cost, to those using it. This would add to the utility of the Bank and its instruments considerably. For this purpose, it would, of course, be necessary that every adult citizen, who has some occasion to make or receive payments in wages, interest or any other form should be required by law to have an account of his or her in a Bank. The postal bank would, of course, be the most common facility as being spread out in the widest possible net-work of branches throughout the country and as such most readily accessible to the poorest man. As already remarked, if the Postal Bank is to discharge all the activities that may reasonably be expected of it, it will have to work in concert with the Reserve or the Imperial Bank of India and engage in all legitimate banking business and not exclusively savings, so that every possible banking facility may come to the door of the commonest individual in the country.

NOTE ON MOBILISATION OF CAPITAL

By
MANU SUBEDAR

The heading selected by the Committee appears to be loose and misleading. This military word means calling up forces in anticipation of their immediate use. This, in its application to the capital of a country, does not make much meaning, because the capital in the form of capital-assets is in the hands of millions of people all over. It means assets, that have a value, which are not intended for immediate use. It involves the savings of the community as a whole in the form of machinery of production and land, mines and forests, in factories, in transport equipment, &c. Over and above all this, there is a fringe of free capital, i.e. capital, which is not yet converted in any permanent form, but which could be converted in whatever form is considered most desirable or attractive. This free capital would be also largely loanable capital.

When there is a war or any other national emergency, various measures are taken, by which the amount of free capital in the hands of the public could be used for the national emergency. Steps are taken, by which it is made difficult to use it for those objects, which may be dear to private individuals, but which would create a diversion of what is needed for the country as a whole.

In peace time and in normal times there may be regulation, but there cannot be, and should not be, heavy restrictions. The regulation with regard to the use of capital would, in the case of India, be regulation in order to prevent duplication and waste in those activities and those industries, which are already well covered and well financed. The regulation is not always against the interest of the owner of the capital, though it is often irksome to individuals, who dislike interference from the state. It may be, for example, decided that, no activity, which would involve capital expenditure, should be undertaken without a licence, and such licence should not be given where, in the opinion of the state, there is already sufficient capital invested. Over-competition is as much an evil as a monopoly, and it is wrong to say that the public reap the benefit of excessive competition, because the uneven and unsteady activity in any industry does not tend to reduce the

cost to the consumer in the long run. On the other hand, it may be the desire of the State to see established in India numerous industries of national importance, particularly from the point of view of defence. No state could afford, in modern times, to go along without industry for the production of transport equipment both by land, water and air, and, so long as the use of force remains in the world even for defensive purposes, no state can do without the armaments industry.

The evil of the armaments industry being owned by private individuals, who stimulate martial ideas and indulge in war-mongering, has been seen in many countries, where, by regulation, armament production is confined either to the state or to strictly licensed companies, and there is adequate production only for home. When the state desires thus to see some activities started early for national purposes, the method is to shut out this scope for other activities by restricting the issue of licences.

To what extent it is possible or desirable to control capital in private hands used for such individual purposes as marriage and death ceremonies, indulgence by extravagant buildings or equipment for personal use, foreign travel with no other object than personal enjoyment, and expensive feasts, dinners and entertainments, appears at the present stage to be a little beyond the scope of our enquiry. But these purposes could be mentioned. They cut not a small hole in the available free capital of the community. Various countries in various ways have been obliged upon occasions, to put checks even in normal times, and many more countries have done so in times of emergency. There are, further, activities connected with popular enjoyments, such as circuses, carnivals, horse races, dog racing, theatres, cinema, and fetes. There are outlays on exhibitions, some of which are run commercially. It is possible that some of these things constitute bona fide trade in the hands of many people. On the other hand, from the point of view of the country as a whole, even if some of these activities bring money to the pockets of some individuals, they may be, on some occasions at all events, and, if carried on in an unregulated manner, at all times, a danger. The regulation may take the form of restriction of quantity as well as of a tax both for this class and the class mentioned at the beginning of this paragraph.

If by mobilisation is implied, how and in what manner the state can get hold of the free capital in the hands of the community, we would say that such an attempt ought not to be made until the purposes, for which the state wants the

money, have been carefully examined. It is not always that capital in the hands of the state is more usefully spent than capital in the hands of the private individual. On the contrary, in some cases, it is private greed, which leads to the finding and the establishment of new enterprise. To the extent to which, however, the state has defined its objects and is satisfied by all possible tests, that the objects are such as should take priority over all prior activities, to that extent the method for securing an adequate amount would be as follows.

All individuals seek safety for the funds which they have saved. Many of them have funds in amounts, which are too small for any independent activity. These mass savings collectively run into crores of rupees. If there were easy means of putting savings into a safe custody in the hands of the state and if the machinery was not cumbersome, easy to understand and incapable of being misused, much money could be secured from the working classes. The savings bank in India is already established on a sound footing, but in many directions its activities could be expanded so as to make the savings bank the poor man's bank. It is receiving deposits. Very rightly, it is not lending out, but we think the possibility of its undertaking remission work should be explored. In the first instance it should be possible for the savings bank to remit money free of cost from the account of an individual "A" in one place to the account of the same individual in another place. Later it should be possible to attempt the next step, viz. to remit from an individual "A" in one place to an individual "B" in the same place. The third stage would be, when the remission of money would be made possible free of cost from an individual "A" in on place to an individual "B" in another place. These facilities are bound to increase the amount of money remaining in the hands of the state at any time on the savings bank account. They are bound to increase the deposits.

The postal cash certificate represents a system of saving convenient to the state as well as the party, who has the spare cash. It is in the nature of a fixed deposit for the period indicated, generally five years. It has been found necessary and useful to allow means for cashing earlier, if some unforeseen event occurs and in such a case there is the penalty of reduced interest being given. A considerable amount of capital falls in the hands of the state by this machinery and, if other facilities than those, which are at present supplied, are asked for by the public, the state should have always elastic arrangements. But rigid precautions must be taken

against the possibility of fraud either on the state or on the individual holding the certificate.

Voluntary saving by the working classes is difficult at all times. But the instrument of the Provident Fund provides for the working and the middle classes a solatium to the deduction at the source before the wages and salaries are paid out. Such Provident Funds, with reference to the services under them in the hands of the Government, run into a considerable amount and provide useful means for the absorption of Government loans. Very rightly, there are restrictions as to the nature of the investments, in which such Funds could be held when they are in the hands of private individuals, and it is good that, in law, Provident Fund is given preference, when a concern liquidates, or when a party becomes insolvent, over all other claims. The principle underlying is that of a compulsory saving and it is a principle, the extension of which can be certainly considered. In effect, the state absorbs the possible savings in the hands of the working population, not as taxes for its use, but as funds on loan. But, where there is a constant and recurring flow, a certain nucleus always remains with the state.

Insurance premium is another form of the savings of the people, largely of the middle and rich class. Encouragement is given to this by exemption from income-tax. When this encouragement was abused by the rich through a single premium policy and other devices, a limit has been put under the Act of 1939.* This has been done in blind imitation of conditions in the United Kingdom, which are very different. Cash savings, or savings in the form of ornaments, or little agricultural properties, are unknown in the United Kingdom to the working classes. They are the usual rule in India both

*Section 15(1) "The tax shall not be payable in respect of any sum paid by an assessee to effect an insurance on the life of the assessee or on the life of a wife or husband of the assessee or in respect of a contract for a deferred annuity on the life of the assessee or on the life of a wife or husband of the assessee or as a contribution to any Provident Fund to which the Provident Fund Act, 1925, applies.

(2) Where the assessee is a Hindu undivided family, there shall be exempted under sub-section (1) any sums paid to effect an insurance on the life of any male member of the family or of the wife of any such member.

(3) The aggregate of any sums exempted under this section shall not, together with any sums exempted under the second proviso to sub-section (1) of section 7 and any sums exempted under sub-section (1) of section 58F, exceed in the case of an individual, one-sixth of the total income of the assessee, or six-thousand rupees, whichever is less, and in the case of Hindu undivided family, one-sixth of the total income of the assessee, or twelve thousand rupees, whichever is less."

for the working classes and for the middle classes. Land and property have a peculiar attraction. The savings of people going in this last-mentioned class are lost to the state, while those going in insurance premia are secured to some extent only. Upto 1938, there was no law compelling the investment of premia in Government Paper. Nor was there any schemes of deposits for life insurance companies, which were working in India. Even now the arrangements cannot be considered to be adequate.

The greatest harm, so far as the field of insurance is concerned, is through the working of foreign companies in India. They take away the lion's share of the insurance business as a whole, though Indian companies are now taking an increasing share of life business. Preference to Indian companies at present is entirely on the voluntary basis, as there could be no administrative or legislative action on the part of Provincial or Central Government in the Government of India Act (section 113), by which a discrimination could be made against companies registered elsewhere in the British Empire. The present state of affairs must be considered as chaotic and most objectionable. Insurance, so far as fire, marine, accident, motor car and other risks are concerned, has become a necessity of modern life. Institutions supplying this form of service have grown in India, and yet the bulk of the Indian business goes to foreign companies. This arises principally from the greed of middlemen agents, influential Indians uttering patriotic words outside, getting the agencies of foreign companies tempted by the extra gain to themselves, and becoming channels through which much Indian wealth is drained abroad. The profession of insurance agents must be, therefore, licensed, and the licence should be divided into three classes so as to penalise those, who confine their business to the securing of work for foreign companies in India. Apart from this, there can be many other ways, in which the flow of business to Indian concerns could be expedited. The suggestion, that this proposal is of an expropriertory nature, is wrong. It is the duty of the state to safeguard the interests of its subjects. Many Indians have been known to have lost heavily in the matter of insurance in foreign companies from Austria, Germany, Japan and other places. At one time there was very little obligation even with regard to placing information before the Indian public before a foreign concern was able to canvass insurance in India. While the information is now compulsorily to be filed with the Company Registrar, it is inadequate and in any case there never is any control. It is the prestige of the local agent, which secures the business. The local

agent earns his commission, but the bulk of the profits are remitted abroad. Even taxes paid by foreign concerns to the state are inadequate, in spite of the recent tightening of the machinery.

With regard to life insurance, we would advocate the concentration in the hands of the state of the life insurance business in the country. This is known crudely as nationalisation. The grounds for this suggestion are again, to safeguard the public against mushroom companies, which grow up, advertise, mislead and cheat. In other cases difficulties are made at the time of the payment of the claim, and arbitrary delays and deductions are not unknown. In most cases the cost is heavier than would be the case under a State Scheme. Life insurance business belongs to that class of routine enterprise, in which no enterprise is required. The premia to be paid are based on statistical returns. The penalties for interrupted instalments, or non-payment, are in many cases unduly heavy. The canvassing, agency, direction and other charges are unnecessarily high at present. The Post Office could, after the preliminaries are settled, collect the payments. This machinery, on which expenditure is already made, could be used for the purpose without serious additional outlay. The other ground, on which the scheme is recommended, is that frauds, through the inefficiency or dishonesty of doctors or agents, which constitute one of the bug-bears of the life insurance business, would be less frequent in the state scheme, as the state would have the machinery of the district administration and the police to effect the enquiries essential for checking up facts regarding a new policy. The suggestion, that corruption would be much bigger where the state is concerned, is gratuitous. It is not borne out by experience in other fields and it belongs to that order of diffidence, which must be depreciated, as it would prevent every scheme for the amelioration of the people.

The greatest merit of the scheme suggested is, however, that an enormous and growing amount of money at present flowing into private hands—partly in foreign hands—would fall into the hands of Government to be used beneficently for the people. The indications given here are only of a skeleton scheme and are necessarily sketchy. The details, however, could be worked up at any time when the general principle of the scheme was approved. We consider this as the biggest and the most smooth running project for drawing the necessary capital for beneficent purposes in the hands of the state. Indeed this would be one of the methods to stem the export of a country's savings to foreign countries and even, under

the 1935 Act, the creation of a state monopoly directed equally against private enterprise, which is Indian or British, or foreign, would be valid. A suitable arrangement would have to be made for existing business in the hands of private enterprise, and Indian companies, which would lose their work would have to be compensated and their staffs absorbed in the state work.

Another class, which has savings which are not fully used at present, are shroffs, Mahajans and traders in the interior, who have to deal on the cash basis. The increase of banking habit everywhere would reduce the need for free capital in the hands of private individuals. Once the money goes into banks, it will come to the state either directly or through the banks buying Treasury Bills.

The amount of idle money lying in the pockets of the people and in their homes is still enormous. This is due to the popular habits in India, which cannot be changed in one day, but it should be possible, by changing the habits of holding the money in the form of coins and notes, and by changing the habits of the people with regard to purchases made by them and with regard to payments made by them, to bring about a larger use of credit instruments, such as the cheque, than hitherto. This, again, would drive most of this money either in savings banks or in commercial banks, and from their hands into the hands of the state.

Comments are not made here with regard to the possibility and the extent of borrowings of the state, as the same has been dealt with in the chapter on Government borrowing. But it is clear that Government borrowing should be done intelligently. You can only mobilise an army, which exists there. You cannot make an army out of a rabble in one day, and very harsh regulation would defeat its own end. If the state took too much money from the public, it will starve trade and industry, which would, in their turn, not only impoverish the community, but dry up the sources of taxation. The state must, therefore, regulate its borrowing strictly to its needs and choose the time when to put forward its loan programmes in such chunks as the market can readily absorb. The state, further, has to provide loans for all classes of lenders—those who wish to lend for a month or two, and those who wish to lend for a long period, those who have got money in January, and those who have got money in the next month, those who are willing to take some risk for a higher per cent and those who are not willing to take any risk. It should be possible to have Government security in suitable form on tap. There is no charm in putting forward loans once

a year in large volume. It has only a disturbing effect on the market. The market jobbers and others like it, because it gives them an opportunity in the ups and downs to make some money from the public. The permanent investor would be happy if he could get Government loans at a given rate any time during the year.

The driving of certain funds, such as trust funds and the funds of insurance premia, into a narrow channel, of which Government loans constitute the principal item, has been the other method adopted everywhere. It has also been adopted in India, but its variations and niceties could be further studied. There is no reason why religious trusts and charities, caste funds and all other funds of a communal nature should not be compulsorily held in Government securities. The alternatives at present, viz. giving out in mortgage, or purchasing properties or keeping deposits with private individual firms or in banks, are not fields, which would be starved out, if this restriction was made.

The capital levy is the privilege of every state, but it is seldom used in peace time. It is used in an emergency when it is seen clearly that the state is not in a position to meet its current obligations from taxation, however heavy it might be. Capital levy, however, is a very complicated issue. Being an emergency tax, there is no material available in the hands of the Government to make clear as to what is to be taken. The different forms of capital have to be valued, which is a problem by itself of no small magnitude at any time. Capital levy, because it involves the payment of funds, which the owner of the capital asset has not immediately got, only drives most of the holders into the market either to borrow or to sell. The rates for loanable capital would, therefore, go up and the value of real property, lands, factories and equipment come down. This displacement in economic life does not in the long run benefit the state to the extent to which it appears to benefit on paper. The paper calculations are misled by a general movement, which has a deleterious effect with regard to future capital savings. There is a general desire to take capital out of the country. A certain amount of the capital does fly out of the country, and foreign residents and others are deterred from bringing more money inside. Unless the emergency is, therefore, one of life and death, the capital levy cannot be suggested as a means for the state to get hold of capital funds.

Capital levy in effect is only a variation of a compulsory loan programme. The compulsory loan programme has been used, often by secret persuasion, in many countries. Persons

in authority would call up men of status and resources and would put down, after some bargaining, the amount, which they have to take, of the new issue of Liberty Loan, or whatever it is called. The immediate effect is that, as soon as a person has subscribed, not having the money to pay, he goes to the market to sell it off. There is a discount—and sometimes a heavy discount. The person forced to pay the loan finds the money for the discount. In fact he has paid a tax, the money for which goes into the pocket of the state today, but which comes out of the pocket of the state when the loan is repaid.

Repudiation of all debts, or, partial writing down of loans, has occurred in many countries. It is the worst expedient, which could be adopted by a state. Conversion, on the other hand, is a legitimate remedy which has the effect of reducing the burden of interest charges; but it does not increase the volume of capital forthcoming to the state.

It will be seen thus that, when the state decides to get hold of free capital in the hands of the community, which is not unlimited at any time, great care has to be taken as to the manner, method and the volume of public borrowing put forward. If such care is not taken and if there is an excessive issue, there will be an immediate depreciation and the credit of Government would suffer. When the credit of Government suffers, the burden is borne by the tax-payer by increased interest charges, as there is more disinclination to support Government loans than before. An excessive issue of bonds, cash certificates, or any other variant thereof, has the same deteriorating effect on Government finances generally, as the excessive use of the printing press. It is open to every Government to issue more currency and to replenish its diminishing resources by a still larger issue. Such a device, whenever it has been used, either through the tyranny and greed of an individual, or through the dire need of a nation after a prolonged war, has invariably led to grave economic disorders, from which it takes the country many years to recover. Not only is this expedient, therefore, to be avoided, but everything, which is a refinement of the same expedient, must be carefully eschewed.

NOTE ON AGRICULTURAL CREDIT

By

MAURICE FRYDMAN

Conclusions:

1. In the present social system there is no hope for the agriculturist to get rid of his chronic indebtedness without a sweeping legislative and financial action for

   (a) debt conciliation,

   (b) limitation of the accumulated interest to 100% of the principal or to 5% simple interest, whichever is lower.

   (c) Issuing of State bonds bearing a nominal interest, say 1%, and making obligatory on the creditors to accept them in liquidation of debts. The bonds should be made redeemable at the rate of 2—2.5% every year. The bonds should be given all possible privileges of a government security and special steps should be taken to keep up their marketable value at par.

2. All short term credits should be given through Village Banks. The Village Banks should be financed by the villagers and the moneylenders on the basis of collective security of the entire village or group of villages. The Village Bank should also become the purchasing and marketing agency for the village.

3. Long term credits should be given by District and Provincial Land Mortgage Banks. They should be financed by the State **out of the State revenue**, and should not invite profit seeking capital, because:—

4. In the present state of land sub-division and low soil fertility all investment on land improvement and irrigation cannot pay even a comparatively low bank rate of interest.

5. It should be made obligatory on the Governmnt to set aside a certain proportion of the land revenue for financing agricultural improvements through interest free loans, repayable in easy instalments.

6. Irrigation and prevention of land erosion, and reafforestation come under land improvement and should be financed out of revenue only.

7. All imports of agricultural products should be heavily taxed and the revenue from this source ear-marked for the major land improvement schemes. The raise of agricultural prices should benefit the primary producer first through proper legislation concerning tenancy, rural marketing and control of grain trade.

RESOLUTIONS OF THE NATIONAL PLANNING COMMITTEE ON THE REPORT OF THE SUB-COMMITTEE FOR CURRENCY AND BANKING

The Interim Report of the Currency and Banking Sub-Committee was presented by Mr. Manu Subedar, Chairman of the Sub-Committee, on the 7th May, 1940. Prof. C. N. Vakil, Secretary of the Sub-Committee, was unable to be present. Discussion continued on the 9th and 10th May. The following resolutions were tentatively adopted:—

1. The Reserve Bank of India is dominated by British financial interests and carries out policies dictated by them. The Bank must, therefore, be nationalised and be owned and managed by the State.

2. Banking business of every description must be carried on under a license, and must be subject to such regulation, supervision and general control as the Central Banking authority imposes from time to time.

3. One of the essential conditions of the license to do banking business in this country should be that at least 95% of the personnel will be Indian. In the case of banks registered in India, all the directors should be Indian nationals, the employment of any foreigner in any such bank will be left open as expert adviser only, and not as chief executive or manager.

4. Banks not registered in India should be prohibited from receiving any deposit or raising loans, in the same manner as in the United States of America.

5. Banking facilities in the country must be widened and made easily available to the mass of the people, by means of an adequate number of branches of large Joint Stock Banks, small local banks, improvement and extension of Post Office Savings Banks, Co-operative Banking Societies, and private bankers, under a proper system of regulation.

6. All inland remittance charges should be eliminated. The Hundi system should be encouraged and strengthened, and Discount Houses should be established.

7. The Stock Exchange should be re-organised, and should work under very strict public control, so that they might function primarily as institutions to help investors.

8. All commodity markets, in which future or forward dealings take place, must be under regulations approved by the State.

9. All import and export trade must be done under a system of licenses, which should be freely given; but which are so designed as to enable the State to have the fullest information regarding the direction of the trade, and to facilitate control and regulation as they are found necessary.

10. Increasing use should be made for foreign trade in staple articles, of recognised corporations, especially charged with functions of exporting and importing.

11. The entire foreign exchange business of the country should be conducted under the complete control of the Reserve Bank, and in such manner as it may determine from time to time. The Reserve Bank should make Foreign Exchange available to the other banks within limits of safety for the external value of the Indian currency.

12. Drastic steps should be taken to prevent drain of funds from the Indian money market in respect of insurance premia. The State should exercise greater control over all insurance funds with a view to ensure not only their safety but maximum utilisation for national purposes.

The Sub-Committee had recommended the extension of the State Insurance Scheme to the public with a view to eliminate private enterprise in this field. As this question had also arisen in the consideration of the Insurance Sub-Committee's Report, it was decided that a decision should be taken at a later stage.

13. The value of the Indian Currency Unit, whether at home or abroad, should be regulated exclusively by considerations of benefit to the Indian national economy, and not in the ruinous manner as at present, when the Rupee is linked to the Sterling. The link of the Rupee with the Pound should be broken as early as possible, all necessary steps and precautions having been previously taken.*

14. While in Planned Economy, fluctuation and depressions will be reduced to a minimum, it is desirable that, mean-

*There was a Note of Dissent to this Report by Prof. K. T. Shah, which was discussed for some time. Several Members stated that while they were attracted by this new approach to money, it was not clear to them how it could be made feasible and practicable. It would be in the nature of an experiment. Mr. Ambalal Sarabhai suggested that Prof. K. T. Shah might write a fuller note on the subject, explaining his ponit of view and how it could be applied. This note should be circulated to members of the N. P. C. Prof. Shah agreed to this.

while, these should be controlled, and sudden or prolonged fluctuations avoided, by the Central Monetary authority in the country. For this purpose several Index Numbers, based on different commodities and different considerations, should be kept to indicate the direction of these fluctuations as also the progress of the Plan. The Central Monetary authority should regulate the price levels and other conditions through the adjustment of the volume of currency and credit.

15. No reserves against the Indian Paper Currency, or the Indian Credit and Banking system, should be in sterling, as hitherto. All such reserves should be normally in India, but the Reserve Bank should have discretion and powers of holding a portion at such places abroad (in gold only in quantities laid down by law) as is considered desirable and necessary. Reserve in gold should not be permitted normally to be kept out of India.

16. The export of gold from India on private account must be prohibited forthwith, and the import of gold must be confined to the Reserve Bank only.

17. To improve the credit and financing facilities available to the primary producer, we recommend that warehousing facilities should be provided or organised by the State all over the country to enable the producer to place his produce in such warehouses. We recommend that the charges in connection with these warehouses should be eliminated and borne by general reserve, or, in any event, such charges should be as low as possible. Against the produce thus deposited, a receipt should be given to the producer who should be entitled to raise the money needed on the strength of this receipt.

18. The State will prevent profiteering and control price levels in the interests of the consuming public and of Planned Economy.

19. We recommend the establishment of Consumers' Associations at principal centres, with a view to protect the interests of the consumer in respect to quality, price and weight of goods, etc.

In order further to protect the buyer and check the habit of bargaining, we recommend that retail dealers should be made to fix their prices and exhibit them openly.

QUESTIONNAIRE ISSUED BY THE N. P. C.

1. What are the institutions concerned in the mobilisation, attraction and investment of local or foreign capital? To what extent do these institutions need to be varied, improved or expanded, so as to supply adequately the capital needs of Agriculture, Industry, Commerce and other essential services to secure the optimum development of the Province's all round?

2. What measures, if any, have been adopted in your Province to control the supply and regulate the conditions of working of foreign capital invested in the industrial concerns operating in your Province?

3. To what extent is the reservation, provided for in the Constitution of 1935, of all powers and functions in regard to the control and regulation of credit, currency, and therefore also of prices within the country in the Central Government of India, a factor militating against the success of any scheme of internal fixation or control and regulation of prices within the province by the Provincial Government?

4. In the absence of any control of the currency and credit system of the country, in the hands of the responsible Provincial Governments, how far would it be possible for Provincial Government to introduce a system of internal barter, so as to reduce the importance of the cash nexus in the settlement of any trading transaction in the Province, and thereby avoid the influence of outside factors affecting the general price level?

5. What are the possibilities of attracting Investment Capital from

(a) other provinces;

(b) other countries

to and in the process of carrying out the programme of Planned Economy as applied to your Province? On what terms and conditions would you consider the attraction of such outside capital for such a purpose?

6. What are the banking facilities available in your Province? To what extent would it be necessary to improve the industrial and agricultural financing now done in your Province and to improve the credit of industrial workers in general?

7. How far have the Institutions named below succeeded in mobilising the Capital Resources of your Province?

(a) Co-operative Societies.
(b) Post Office Savings Banks.
(c) Postal Cash Certificates.
(d) Savings Department of ordinary banks.

8. How far is it possible for the Provincial Government directly by themselves to finance the establishment of new industries in regard to the fixed as well as working capital, or in association with private enterprises?

9. In the event of the Provincial Government or any Local Body; working in partnership with private enterprise, any provincial industry, utility or service, what should be the terms and conditions of such partnership specially in regard to

(a) general supervision over the conduct and management of the concern,
(b) treatment of labour,
(c) interests of consumers,
(d) provisions of reserves,
(e) sharing of profits, and
(f) eventual acquisition of the entire enterprise by Government?

SUMMARY OF DEVELOPMENTS

Many developments have taken place, some of a far-reaching, fundamental character, in the Currency and Banking System, as well as the Credit machinery of this country, in the eventful years during and after World War II. Within the scope of this Volume, it would be impossible to take note of every single Ordinance, Legislation, or executive order, affecting this part of our national economy, and the changes they embody. As explained in the Introduction, many changes have come upon India's domestic and foreign Trade and Finance, which have completely altered the shape of things. The basis of our Currency System,—the silver Rupee,—is now technically, an independent coin. But its links with sterling have not yet been broken. Its silver weight and fineness have been reduced to half since 1942; turned into a nickel coin since 1946, and its design and appearance altered materially. This has, however, no more affected its essential position in the popular mind as the Standard of India's Currency (?) than the changes in the shape and design of the Currency Notes of the several denominations. The demonetisation, early in January, 1946, of the Currency Notes of high denominations, like Rs. 1,000 and Rs. 10,000, was intended as a blow to the Black Marketeer, or war-time Profiteer, who had evaded taxation, and hoarded his ill-gotten gains in these higher denomination Currency Notes.

Changes in the policy of Price Control, with far-reaching repercussions on internal and foreign trade, have been many and varied; and have been noticed more at length in other more appropriate volumes in this Series. Other minor developments could also be mentioned; but the Summary would swell to disproportionate length if one were to include every change, modification, or development in these integral parts of our national economy. Note will, accordingly, be taken only of such changes and developments, which affect the very roots of the system, and have reaction on any scheme of wholesale planning which must be taken stock of before Planning could be perfect and satisfactory.

1. Inflation

Amongst the most important of these developments, pride of place must be given to what has come to be known as Inflation, or the swelling in the volume of Currency in circulation, and the consequent rise in prices, both resulting from the accumulation of Sterling Securities in our Paper Currency

Reserve, and of "cash balances held abroad" in the Banking Department of the Reserve Bank of India. A table given elsewhere shows the rapid increase, since 1939 in the Note circulation; and the one sub-joined indicates the inflation in prices up to the latest date.

Index Number of Wholesale Prices (Sensitive Series) in India by Groups of Articles and Cost of Living in Bombay since 1939-40

(Average of weekly figures.)

Year and Month	General Index	Cost of Living* (Bombay)
1939-40**	125.6	105
1940-41	114.8	109
1941-42	137.0	122
1942-43	171.0	166
1943-44	236.5	226
1944-45	244.2	225
1945-46	244.9	228
1946-47	275.4	252
1947-48	307.0	268

* Monthly indices: Base—August 1939=100: Annual figures are erages of monthly indices. Source. Bombay Labour Gazette.

** Seven months ended March, 1940. Source: Report on Currency

Index Movement of Wholesale Prices in India.
(Base-Year ended August 1939=100)

	July (1947)	June (1948)	July (1948)	% increase (+) or decrease (—) in July 1948 as compared with June 1948.	% increase (+) or decrease in July 1948 as compared June 1947.
I. Food Articles:	291.5	377.0	392.1	+4.0	+34.5
II. Industrial Raw Materials:	371.0	450.8	449.9	—0.2	+21.3
III. Semi-Manufactures:	256.0	323 4	338.2	+4.6	+32.1
IV. Manufactured Articles:	274.9	370.1	370.2	..	+34.7
V. Miscellaneous:	449.8	520.0	537.3	+3.3	+19.5
VI. All Commodities:	297.7	382.2	390.1	+2.1	+31.0

All controls on Foreign Exchanges, all changes and developments in the monetary system, all regulations of local and overseas trade of capital issues etc., are, in one way or another, traceable to this group of problems centering round the question of controlling Inflation, and realising our huge resources locked up in the so-called Sterling Balances. Even the institution of the International Monetary Fund and of the International Bank, are inextricably mixed up with these. The Summary will, therefore, begin with a brief account of this problem.

* Inflation: Concealed Taxation

Inflation has been popularly defined by a recent writer to consist in an enormous rise in the circulation of currency or Legal Tender, particularly Paper Money, backed purely by Government Securities, created, generally, to meet current Budget deficit. No adequate gold, silver, or Foreign Exchange (valuta) cover is provided against this Paper Currency which becomes practically inconvertible. Fresh Notes are issued without any co-relation with the real demand arising out of an increased wealth production, or improved standard of living; and consequent increase in the demand for Medium of Exchange to bring about a better distribution of the goods produced.

All these conditions are found, as shown by the preceding Tables, to have been at work in India during the War years, 1939-45; and, three years after the War, they have not ceased to operate. Attempts at controlling prices of essential goods have failed to yield all the desired results, because of the continued Budget deficit, and, therefore, of the fountain-spring of Inflation. It is, indeed, true, that not every rise in the price-level is to be condemned; since rising prices are often a correct index of growing prosperity, expanding industry, or improved standards of living. But all indices in India today point to the fact that production in Agriculture as well as Industry has fallen; and that the improvement in the standard of living is not at all commensurate with the seeming rise in wages, such as it has been. The problem, therefore, exists in a particularly virulent form, and is becoming progressively more acute.

The growing anxiety caused by this problem has at last been realised by the powers-that-be, who have called in several interests and individuals to advise them as to the ways and

*Cp. "How India Pays for the War" by K. T. Shah, p. 98.

means of dealing with it. Those representing specific interests naturally put forward suggestions suited to their own particular interests, though to any one impartially scrutinising the suggestions, the extent of the common ground among all persons consulted, would appear to be amazing. The independent or non-official economists called in consultation, were probably the least biased, though they are frequently charged by interested parties to be lacking in a sense of practicability. Even so, their recommendations seem to be sufficiently varied, far-reaching, and going to the root of the problem to deserve more than a passing glance in this Summary.

The Economists called into consultation by the Central Government in August, 1948, ascribed the present evil of Inflation to:—

(i) Continuous inflation of currency during the War period to provide funds for the heavy purchases on account of the British Government.

(ii) Continued budget deficits at the Centre, on both Revenue and Capital account, even after the end of World War II, aggravated by deficit budgets in most of the Provinces during the current year.

(iii) Sudden and unplanned removal of controls on prices and distribution of essential goods.

(iv) Increase in active money due to transfer of cash and balances, as well as large scale conversion of capital into cash or balances consequent on the vast migratory movements.

(v) Additions to money supply by open market operations of the Reserve Bank in support of Government securities.

(vi) Pressure of money made in the Black Market, and of incomes evading taxation on prices. No one can say the exact amount of this money; but reliable estimates put it at over 500 crores. Perhaps a good portion of these is lying in secret hoards, or used to buy gold, jewellery or immovable property, all which swell the actual or potential purchasing power.

(vii) Disinclination on the part of the agricultural producer to sell, due to the fall in the burden of his cash obligations and the rise in his money income.

(viii) Decline of industrial output from war-time peaks, because of shortage of material, fuel, stores as well as increased wages.

(ix) Increases in money incomes of several classes.

(x) Failure of Government borrowing and savings campaigns.

These consultants considered the danger to be so grave, that they recommended the country's economy be put on a war footing, and determined efforts made to fight Inflation before it was too late. Others consulted, representing Sectional interests of Capital and Labour, substantially agreed with this diagnosis. The remedies suggested below might create sectional opposition, but public opinion must be aroused and employed in favour of them to meet the present emergency.

These remedies were fourfold:—

(a) Fiscal, (b) Monetary, (c) those relating to Control over distribution, and (d) those concerning increase in production.

A. Fiscal Measures

These are primarily connected with the Central Budget. It is necessary to give early effect to them so as to bring the situation under effective control as soon as possible.

Expenditure: Current and Capital

(i) On the side of expenditure retrenchment should be taken up much more vigorously. War-time and post-war growth of staff in Departments both at the Centre and in the Provinces should be carefully scrutinised for all possible retrenchment. An Economy Committee is in fact actually at work. But it progresses so slowly, and spasmodically, and works on such narrow, uneconomic principles, that many fear, in solving one set of problems, it might give rise to a whole host of others, no less complicated or distressing.

(ii) All expenditure of a social, educational and welfare character should be reviewed carefully. However desirable such expenditure may be, in the present emergency, only so much of this expenditure should be undertaken as can be met from current revenues or additional taxation.

(iii) Defence Budget is also unduly inflated and needs strict scrutiny. In the present world situation, however, one wonders if any large-scale economy or retrenchment is possible on this head. War is actually raging in Kashmir, and others may be in the offing. We have won our independence much too recently to run any avoidable risks in this behalf.

(iv) Grants to Provinces out of the Central Budget, itself in deficit, are inflationary. They should, therefore, be discontinued, except where it could be demonstrated that they would add to the production of essential commodities in the immediate future.

(v) Schemes of current expenditure considered to be productive should also be carefully scrutinised. All such outlay should be commensurate with actual results.

(vi) All other expenditure should be rigorously reviewed; and every pie of waste or unnecessary spending should be ruthlessly avoided.

(vii) Refund or EPT deposits should be postponed, except where such refunds are demonstrably required for productive reinvestment.

(viii) Capital expenditure should be met entirely out of genuine borrowing. All such expenditure not immediately productive should be withheld, however attractive such investments may seem to be in the long run.

(ix) Prohibition programmes were considered as bound to aggravate inflationary trends; and as such ought to be deferred for a more favourable moment.

(x) Proposals for **zamindari** abolition which require compensation to be paid, should be so devised as not to lead to an additional injection of cash into circulation.

Taxation

Having reduced expenditure wherever possible, attention must next be paid to increase revenue resources to fill up the Budgetary gulf.

To this end, it has been suggested:—

(i) The Income-tax Investigation Commission should be armed with all necessary powers to secure to the Treasury as much of the evaded tax income as possibly managed. It is generally believed that this one source alone would, if properly handled, more than suffice to make up the present deficit.

(ii) The introduction of a graduated surcharge on income tax, on personal incomes above Rs. 5000, should be imposed.

(iii) Business Profits Tax should be increased to 25%.

(iv) Personal Super-Tax should be raised to the levels of 1947-48.

(v) Steeply graduated Death-Duties should be introduced.

(vi) Agricultural income tax should be introduced in all Provinces, and should be levied on the same lines as the general Tax on incomes.

(vii) A graduated surcharge on payments of land revenue by holders who pay more than Rs. 200 per annum should be introduced everywhere.

Borrowing.

On the Capital Budget side, the Economists suggested:—

(i) The introduction of Treasury Bills of six months' and one years' duration, at slightly higher rates of interest.

(ii) No increase in the Interest rates on Government borrowing. But the attractiveness of small savings should be augmented (a) by the issue of non-negotiable three and five years Savings Bonds at a higher interest than that now given on negotiable bonds of equal duration; and (b) by the issue of National Savings Certificates for three and five years.

(iii) No significant expenditure be incurred from the collection made for the Mahatma Gandhi Memorial Fund. It should for the time being be invested in Government securities or held in deposit with Government.

(iv) Terminable Government loans maturing should not be repaid immediately if there is any option under the Loan Terms.

(v) Bonus receivable by industrial. workers, whose annual incomes exceed Rs. 500, should be made in the form of Savings Certificates;

B. Monetary Measures.

(i) The maximum of the total value of Notes issued by the Reserve Bank of India should be limited to the existing amount, with a margin of discretion to meet genuine variations in seasonal demands.

(ii) All banks be required to hold Government securities to the extent of 25% of their total demand liabilities, provided that the Reserve Bank may permit exceptions in suitable cases. A general freezing of all current accounts deposits has been considered, though for reasons of expediency not recommended as a measure for immediate adoption.

C. Controls.

Capital Issues Controls.

The present system of capital issues control should be modified so as to make capital issues for industrial enterprises as free as possible, although capital issues for financial institutions like banking companies and investments trusts should continue to be scrutinized with the utmost care. This relaxation should be subject to the proviso that where capital is issued by companies and immediate equipment is not available such funds as are raised by the companies should be held in investments in Government securities pending their utilisation as and when real capital becomes available.

Raw Material Controls.

Controls for the allocation of essential materials like steel, cement, etc., should be continued, to help the production of essential consumer's goods.

Import Controls.

Imports of essential consumer's goods should be given preference. The list of goods imported under Open General Licence should be as large as possible. But a policy of discrimination against the imports of non-essential goods should be carried out. The possibility of importing capital goods from countries like Czechoslovakia, Canada, Australia, Japan etc., should be thoroughly investigated.

Export Controls.

Export controls should be exercised with a view to enable the country to implement any bilateral trade agreements which it may enter into for the purpose of securing imports of essential supplies. This could be done either by a complete State Monopoly of Foreign Trade; or by permitting importing countries to buy and export the commodities guaranteed to them under bilateral agreements.

Essential supplies imported in return for such exports should be allocated to industry by Government, so as effectively to increase the production of essential commodities at once. Provision should also be made for the equitable distribution of essential consumer goods obtained as a result of such agreements.

Personal Income Controls.

It is necessary to freeze all personal incomes such as wages, salaries, and dividends, even though it involves some inequality of sacrifice.

Dividends declared by companies should be limited in the case of existing companies to the average of the last two years' dividends. In the case of new companies they should not exceed 6%. Undistributed profits resulting from the dividend limitation should be held as compulsory deposits against one or two year Certificates.

Food Controls.

With the freezing of salaries and wages, government must face the obligation to prevent prices of food-grains from exceeding their existing levels. Ceiling prices should therefore be notified for all food-grains, in both urban and rural areas.

In the urban and industrial areas it is also necessary to arrange for controlled distribution of food-grains through ration shops, in order that the cost of living of industrial workers and other wage and salary earners may be stabilised at levels not much above of those which prevailed before the recent spurt in food prices.

Supplies for this purpose should be obtained from imports and from domestic resources. The latter should be obtained by a compulsory levy imposed on every agricultural holding, yielding more than 25 maunds, supplemented, if necesssary, by purchases in the open market. Prices paid should be the lowest practicable, Government should subsidise the sale of the domestically procured grain on the same basis as imports. The cost of such subsidy must be met out of current revenue.

The Provincial Governments in deficit provinces may extend rationing also to the rural areas provided:—

(i) they do not expect to get any additional quotas from the Centre on this account.

(ii) the prices they pay under any scheme of monopoly procurement should not be very much above the prices at which food-grains are now being sold in ration shops.

Controls of Other Commodities

Control of prices and distribution of cotton and cloth is being reintroduced. It should be elaborated on lines of a state monopoly. Controlled maximum prices should be fixed for oilseed and prices as well as distribution of other commodi-

ties as paper, vanaspati, cement, steel, coal, kerosene, charcoal, sugar, etc. should be continued or reintroduced.

D. Production

A programme of production targets should be laid down for each major industry. Small-scale and Cottage Industries should be fully developed to mitigate the essential shortages.

New companies in the major fields of productive industry should, by way of incentives be granted some rebate of taxes and schemes of production bonuses of significant amounts, based on production above a standard output. All efforts to increase agricultural production should be intensified without delay.

Most of these suggestions are awaiting implementation, pending the Cabinet's decision on basic policy. Individual recommendations have, however, been taken up for being given effect to.

II. Sterling Balances

Another significant feature of the war which was closely connected with, and was the main cause of the problem of Inflation, was the accumulation of huge Sterling Balances in London of the order of Rs. 1,654.71 crores, after the Sterling Debt of the Government of India, amounting to Rs. 429.28 crores, had been repatriated, the sterling being utilised to pay for the earlier War purchases of the British Government and their allies in India. After the War, and in consequence of a provision in the Anglo-American loan, Britain was anxious to settle the Sterling Balances held in London by India and other countries. Temporary agreements were made with India in 1946 and 1947 lasting for 6 months at a time, and releasing a small amount of the balance to be converted into hard currencies. But this kind of tinkering was satisfactory to none of the parties concerned; and so negotiations of a more permanent character were taken in hand in 1948.

A delegation led by the Finance Ministry went to London in June, 1948 after the ground had been prepared by Secretaries as well as by an understanding with the Pakistan Government.

The Sterling assets of the Reserve Bank had declined a during the year by Rs. 29.48 crores as compared with a net decrease of Rs. 120.25 crores in 1946-47. This decline was due mainly to a deficit in the country's international transactions on current account, caused among other factors by heavy im-

ports of food on Government account as well as by permissible capital transfers.

The total Sterling holdings in the Issue and Banking Departments as on 30th June, 1948, amounted to £1,152.50 million or Rs. 1,536.67 crores, which are maintained in the form of cash and investments in short-term British Government securities. Technically these are assets of the Reserve Bank of India which can at any time demand their liquidation from the Bank of England. Interested, however, as the Reserve Bank is in Foreign Trade finance, from its point of view, the rapid depletion of these assets, during the latter half of 1946-47 caused anxiety. They felt that these balances, represented almost the entire Foreign Exchange reserves of the country; and as such should not be used to finance the normal current external deficit. That should rather be met from the earnings of current exports. The accumulated reserves should be drawn upon only for the purpose of importing essential capital goods required for maintaining and increasing the country's productive capacity in agriculture, industry, transport and power generation. On the Bank's representation, Government, decided to follow, from July, 1947, a more restrictive policy in respect of imports. Taken along with the expansion in exports, the result of restricted imports was a rise in the Bank's sterling holdings during the greater part of the second half of 1947-48.

The first interim Sterling Balances Agreement for the period ended 31st December, 1947, which was signed in London on 14th August, 1947, provided for the distribution of India's sterling balances into two accounts with the Bank of England, viz. (1) the No. 1 Account, to which were credited, together with current sterling receipts, a release of £35 million, and a working balance of £30 million, the balance of this account being made available for payment for current transactions anywhere in the world; and (2) the No. 2 Account in which the remainder of the accumulated balances were held and made available only for certain types of capital transactions, and the payment of pensions, gratuities and provident funds outside India.

It was also agreed that the sterling assets of the Reserve Bank would be invested so as not to earn a rate of return appreciably higher than the rate earned as on the date of the agreement.

This agreement was extended in February, 1948, to be in force till 30th June, 1948. India was granted a fresh release of £18 million, after taking into account the excess of £11

million lying to the credit of No. 1 Account over and above the £30 million working balance previously granted. Pakistan obtained a release of £6 million, and a working balance of £10 million, in addition to an amount from the balance in the No. 1 Account due to it under the Indo-Pakistan Agreement of December, 1947. Of the releases granted to India and Pakistan, only £10 million and £3.3 million, respectively, were to be convertible into hard currencies.

The latest settlement was negotiated in June in London, between the representatives of the United Kingdom and the two Dominions for a long-term settlement of the problem of the Sterling Balances. The terms of the agreement then arrived at are:—

This agreement has been arrived at after taking into account the needs of India and her absorptive capacity on the one hand and the present difficult economic position of the U. K. on the other. It provides for the release of a sum of £80 million over a period of three years, which, together with the current balance in India's No. 1 Account of about £80 million constitutes roughly a sum of £160 million available for expenditure over the next three years leaving a reasonably adequate amount of working balance. Also, taking into account the many uncertainties surrounding the position of the sterling area, central reserves of gold and dollars, it was agreed that out of this a sum of £15 million is to be made available in dollars and other hard currencies over a period of one year, this amount being available to India in addition to India's current earnings in dollars and other hard currencies, supplemented by borrowings from the I.M.F. if any. Agreement has also been reached over the purchase of military stores and installations by the Government of India at a cost of £100 million and the purchase of a tapering annuity from H.M.G. for the payment of pensions at a cost of £168 millions, which include Central as well as Provincial Government Pensions.

Nothing has been settled regarding the liquidation of the remaining amount of the Sterling Balances, which aggregate about £800 millions. The present Agreement is expected to last for three years; but with regard to further releases to be convertible into hard currencies, the period allowed is only one year.

The final accounts of the undivided Government of India for 1946-47, showed that a sum of £49 million (Rs. 65 crores) remained due from the United Kingdom under the plan for the allocation of defence expenditure between India and that

country. Certain liabilities pertaining to the period covered by this plan still remain to be met and after allowing for these the final amount due has been fixed at £55 million (Rs. 73 crores). This payment will be in final settlement of all matters arising out of the Defence Expenditure Plan except for certain terminal benefits which will be separately adjusted.

Not only is the Agreement of July, 1948, not final regarding the greater portion of the Sterling Balances, but it is open to criticism, and has been criticised, on a variety of grounds. The entire amount of over £1,152 millions has been taken as a single total, without distinguishing between the amount held in Sterling, in the Paper Currency Reserve or current balance in London at the outbreak of the War. This was estimated to amount to £60 millions; it could on no account have been lumped with the total accumulated during War. It had been suggested to the Finance Minister before the Delegation left to negotiate the Settlement, that these amounts should be kept separate, and insisted to be paid in dollars or gold as part of our Currency Reserves. But the suggestion did not find acceptance; and that amount therefore goes with the rest. Even if these recommendations had been carried out, the amount would, in actual purchasing power, have been much less than the same figure on 1st September, 1939, in terms of real purchasing power. Those who made the suggestion did not insist upon this aspect of the matter being insisted upon; but their moderation was of no avail.

The value of the surplus stores installations, equipment, etc. taken over by the Government of India, from the British Government at the end of the War, has been fixed at a round figure of £100 millions, and the amount agreed to be deducted from the total of sterling balances. No one, however, knows what the real value of these stores, installations, and equipment is.

Much of this is either unusable, obsolete, or impossible to be removed bodily by Britain without incurring a disproportionate cost of transport. Rough estimates made of sample stores, etc. calculated the value of all those at over Rs. 500 crores. But even if these sample valuations should be accepted as giving a correct basis for calculating the total amount involved, the benefit received by India, from the standpoint of serviceability of an up-to-date character of the material, is scarcely commensurate with the amount fixed as the price, and deducted from the total sterling due to us.

The amount agreed upon as capitalised value of pensions may not call for criticism, except, perhaps, on grounds of the

technique of calculations. But the fact that no agreement has been reached, and no settlement made for the very large sum still remaining outstanding, provides the strongest grounds for dissatisfaction with the arrangement. No security or guarantee has been taken regarding the eventual realisation of this amount; no steps have been taken to raise equivalent funds to facilitate the import of food or capital goods from hard currencies areas if necessary, by raising loans in those countries secured from these assets of India held in Sterling. We have capacity of our own to raise and guarantee such loans. But if they are further secured by such assets belonging to us, the terms of such loans would be much easier, and our task of importing goods from such areas much simpler.

Finally, no pledge has been taken from the British Government that, in the event of no satisfactory settlement being made of the amount still outstanding, (payment being made preferably in gold or its equivalent for any reasonable proportion of this amount) the assets owned by British nationals in India would serve as security for India to realise the amount still remaining due to her. The fact, already mentioned, that the settlement is only for a comparatively brief period is another source of anxiety, at least to those who fear the chances of the economic recovery of Britain up to the Pre-War level not as bright as might be hoped that such claims as ours may be satisfied. Add to these the political complications and the danger of the war-like operations which is imminent in the present conflict of rival imperialism and we can understand why the problem of Sterling Balances still unsolved should give continued ground for serious anxiety.

III. Control and Co-ordination of Banking

Note has already been taken in the Introduction of the striking lack of co-ordination in the Banking and Credit organisation of the country. To obviate this defect, and to ensure the greater safety of Deposit holders in Banks, a Bill was brought before the Indian Legislature in 1946 to consolidate the law relating to Banks and Banking. This however, could not be enacted owing to the rush of political developments, culminating in the establishment of Dominion Government. The Constituent Assembly (Legislative) of India has had that proposal once again placed before it, in its autumn sessions of 1948. But the Select Committee appointed on that Bill could not proceed very far, and the enactment has been again postponed. To achieve, however, the principal objective of the proposed legislation, an Ordinance was passed in September, 1948, which gives the following powers and authority to the

Reserve Bank, to ensure the safety of Depositors in Banks.

(1) The Reserve Bank is authorised to grant advances to scheduled and non-scheduled banks in emergencies against such form of security as the Reserve Bank might consider sufficient. This will enable sound banks to be assisted more freely if they get into difficulties.

(2) Grant of unsecured loans and advances by banking companies to directors and to firms and Private Companies in which the directors are interested is prohibited.

(3) Banking companies are required to submit to the Reserve Bank returns of unsecured loans to public companies in which the directors are interested. This is intended to guard against injudicious investment by directors.

Maintenance of Assets

(4) Banks must maintain, at the end of each quarter, assets in India, not less than 75 per cent of their demand and time liabilities in India, so as to prevent foreign Banks operating in India from transferring too large a portion of their assets outside India to the detriment of the depositors' interests.

(5) The Reserve Bank is empowered to control and direct banking companies in regard to their lending policies, so that, where necessary rising prices may be checked by control of credit facilities, or creation of deposit currency.

(6) The Reserve Bank is empowered to apply to a competent Court to be appointed official liquidator, so that, where necessary and possible it may arrange for the orderly liquidation of a bank that is being wound up.

(7) The Reserve Bank can also prohibit a banking company from indulging in practices detrimental to the interests of depositors.

(8) Amalgamations with other Banks or schemes of arrangements or compromise with creditors are prohibited without the concurrence of the Reserve Bank. Thus schemes which are detrimental to depositors' interest would not be adopted.

(9) It also empowers the Reserve Bank to assist as intermediary in proposals for amalgamation.

It is hoped that by this means the country's banking structure would be strengthened, and some undesirable practices which have recently crept in would be stopped.

There is nothing in this Ordinance to stop unnecessary multiplication of Branches, which are deemed, in orthodox banking circles, to be a source of weakness. Figures given in the Introduction, however, would go a long way to show that India is still lacking in adequate number of Banks for its population. There is, moreover, nothing in the Ordinance, and not

even in the Bill as it stands now, to show that the more glaring shortcomings of our Credit Organisation or the functioning of the Banks, are being perceived and much less remedied. For instance, the provision of special type of Banking or aiding Industry or Agriculture so as to contribute directly to increase the productivity, is utterly absent at least in so far as the recently established Industrial Finance Corporation can be said to meet that end.

In other respects also, like economising the use of Currency by devising special forms of credit instruments and adapting them to the requirements of the Indian clientele, the Bill does not make any provision. The guiding principle of the Bill is simply to safeguard the interests of the depositors. There is no thought of the function of the Bank in the economic life of the country and therefore no provisions regarding the special training, aptitude, or qualifications by way of experience, etc. of those who have the direction and management of Banks in India.

Until, therefore, the defects noticed both in the Currency System and in the Banking Organisation are properly corrected; until the two are properly correlated inter se, and until both are made integral part of planned economy, all the benefit that we can reasonably expect from modernised banking would be lacking.

IV. Controlled Foreign Exchanges

The strain being increasingly felt, even during War years, on the stable maintenance of exchange ratio was attempted to be relieved by the Lease Lend system, in which India participated only indirectly and comparatively slightly. The arrangement, however, was a purely war-time measure, whose benefit, it was expressly provided, would stop as soon after the War was over, as possible. It was, therefore, necessary to make some arrangements, for the continued stability in exchanges all over the world, if the war worn countries were to recover and rehabilitate themselves as soon as possible. Britain was the first to realise this; and she applied for a long term loan as soon as the Lease Lend system came to an end. The conditions of the Loan, eventually granted in 1946, were such that Britain was obliged under it to wind up the "Empire Dollar Pool", to liquidate the Sterling Balances, to maintain stable exchanges, to forego any policy of discrimination in trade, etc. It was under this agreement that she was forced to take steps for settling the problem of Sterling Balances, already referred to.

The United Nations' Monetary and Financial Conference held at Bretton Woods (N. H.) in July, 1944, arrived at an agreement by which a concrete programme for international

monetary and financial co-operation including stability of exchanges was worked out. Forty-four nations were represented in the Conference and they signed an agreement concerning the setting up of an International Monetary Fund and an International Bank for Reconstruction and Development.

The agreement signed as the result of the Bretton Woods International Monetary Conference of 1944, is designed to ensure stability of international exchanges. All participating nations agreed to fix the ratios in exchange of their several national currencies in terms of gold. This exchange ratio was not absolutely rigid and inflexible. A margin of 10% variation was permitted, under stress of temporary difficulties. Beyond this, no variation is allowed, except with the consent of the Managing Board of the International Monetary Fund, which was established to control and regulate the working of this system. The Board can consent to a further variation up to a maximum of another 10% of the fixed gold value of a national currency, except under very special conditions of a momentary emergency.

The main object of the International Monetary Fund is to provide member countries with short-term resources (based on the quotas allotted to each country) to enable them to tide over temporary deficits in their international balance of accounts, and so maintain stability of exchange, which was deemed essential to the balanced rapid recovery of war worn countries, and a revival of International Trade. This Fund was to aggregate £2,000 millions, and was to be built up by quotas from members who paid in gold, local currencies and securities. India's quota is fixed at £100 millions—$0.4 billion. The quota is fixed in accordance with a country's position in the international trade, and to govern its borrowing rights, voting rights and share in the management.

No country agreeing to these arrangements, can thereafter regulate its local currency to suit the needs of its own local economy, or of its own trade with other countries. At the same time, each participating country's right to regulate and control its own Foreign Exchange supplies was practically eliminated, except in regard to long term capital investment. Before this agreement a country could devise its fiscal system, so as to direct its foreign trade towards such countries whose currencies were more easily obtainable in exchange, and restrict it as regards those other countries whose currencies were not as easily obtainable. The agreement arrived at at this Conference was to exclude such preferences, after a period of transition from war to peace economy. Each country is now bound to supply any amount of any currency for current (not capital) transactions to holders of its own currency; and this can be

done by drawing upon the International Monetary Fund to a limited extent, in addition, of course, to the normal earnings of the country concerned of other hard currencies. These limits are fixed by and upto the credits to which a member country has become entitled. When these credits are exhausted, and the country still continues to need Foreign Exchange, no normal remedy is provided under the agreement. The only recourse then left to such countries would be to bring about drastic Deflation at home or currency devaluation permitted under the scheme.

There is yet another clause of the Agreement, whereby, if the demand for a given currency continues to be in excess of its supply, the Directors of the International Fund can authorise the member countries to reimpose Exchange controls in regard to such "scarce" currency. At the present time and for years to come only the American Dollar can come within the category of such likely "scarce" currency unless and until the United States either dispense with their own tariff walls, and so facilitate the import of foreign goods, to set off against their excess of exports; or lend to other countries suffering from war wastage until the latter's local economy is rehabilitated sufficiently to permit them to balance their international account.

V. The International Monetary Fund

Although the International Monetary Fund commenced its operations from 1st March 1947, the first exchange transaction took place only towards the end of May 1947. A stabilisation credit of \$.25 million was granted to France and of \$.12 million to the Netherlands, one half of the latter being in pound sterling.

The growing deficit in her balance of payments with the United States led India to apply for the first time to the Fund for purchase of dollars in March 1948, and succeeded in securing initially an amount of U.S.\$.28 million in March, followed later by two instalments of \$8.06 million each in May and June, by tendering the equivalent in rupees.

Along with most of the other members, India also availed herself of the transitional arrangements regarding exchange restrictions. The imbalance in the international payments position of many countries following a decline in production or shortage of essential supplies from certain regions whose currencies were scarce, compelled many countries to restrict Exchange facilities, not strictly in consonance with the principles of the Fund. The actual position was, however, very acute particularly in regard to food in India. Time is needed to restore suitable conditions. The Fund, after declaring its

policy in respect of multiple currency practices, generally agreed to the adaptation, subject to certain principles, of existing Exchange Controls and Currency Devaluation in a few countries. It was hoped that, by helping to iron out balance of payments difficulties in the immediate future, these measures would enable the countries concerned to return to more normal Exchange practices. The Fund would then be able more easily to achieve its long-term objectives of Exchange stability without needless recourse to exchange restrictions.

In June 1947, the Fund issued a directive to all member countries warning them of the undesirable consequences of external sales of gold at prices above monetary parity. Members were asked for active co-operation in eliminating such deals.

In December 1947, the Fund declared its policy against subsidies to gold production. Any member, proposing to introduce such subsidies, was requested to consult the Fund on the specific measures contemplated. In April 1948, the Fund declared that, during the first year of the European Recovery Programme, members participating in the Programme, should apply for the purchase of U.S. dollars only in case of exceptional or unforeseen hardship, so that the resources of the Fund may be maintained at a safe and reasonable level, and at the end of the E.R.P. period, such members may have unencumbered access to the Fund's resources.

VI. International Bank of Reconstruction and Development

Side by side with the creation of the International Monetary Fund, for the more effective management of that Fund, as well as for the fuller realisation of the main objective of rapid post-war recovery from war wastage, loss or damage, an International Bank was set up, to provide long term capital for investment in reconstructive or developmental projects. The Bank, in fact, is called the Bank for Reconstruction and Development. It has a capital stock of $10,000 million, of which only 20% is called up in the initial years of its existence. The rest will be called up as and when needed. Every country which joins the International Monetary Fund must subscribe to the Bank, either directly through its Government, or through its Central Monetary and Credit organisation. Ten per cent, of the capital called up must be paid in gold or dollars, while the balance may be paid in the country's own currency.

With these resources, the Bank can make loans, or guarantee loans raised elsewhere, upto a maximum amount equal to the capital subscribed by it. These loans are to be only for

specific projects of reconstruction or development, which include, however, restoration of assets damaged by or lost during war. For this purpose countries who have suffered during the War from enemy occupation, or because of warlike operations having been carried on on its soil, will be particularly attended to in the loans or guarantees of the Bank for Reconstruction and Development.

The Bank's loans are made to the Government of a member country, or to any business, industry or agricultural enterprise. If such loans are made to non-Government bodies, the Government of the country, in which the loan is to be spent or work is to be executed, must afford a guarantee of the repayment of principle and interest on the loan.

The loans, moreover, are made only when the Bank is "satisfied that, under the prevailing market conditions, the borrower would be unable to obtain the loan as reasonably." Each project for which a loan is to be raised,—usually the provision of some Public Utility, must be carefully scrutinised by an expert Committee, and only on that Committee's approval would the loans be given.

Besides making its own loans, the Bank may subscribe to loans raised by other agencies, on a much larger scale. It is authorised to borrow money for subscribing to such loans, and, also to guarantee loans and make a charge of 1% or 1½%.

The Bank thus contributes to long-term equilibrium in the international balances of payments. The Indian delegation to the Monetary Conference pressed for some provision for a partial multilateral clearing of the wartime Sterling Balances through the machinery of the Fund, in the interests alike of the economic development of the backward countries, as well as of the expansion of multilateral trade, which would assist effectively the broad objectives of the International Monetary Fund. The proposal, however, was rejected by the Conference on the ground of the limited size of the Fund in relation to the magnitude of the war balances. Another claim by our delegation for the allotment of a larger quota, and for a permanent seat on the Executive Committee of the Fund as well as of the Bank, was also rejected, though our quota is large enough to assure continuous election to the Executive Committee of the two institutions.

It may be added that these Articles of Agreement await ratification by the Governments of the participating countries, and will come into force when the Agreement is signed on behalf of Governments having 65 per cent. of the total quotas.

The International Bank for Reconstruction and Development began active operations in May, 1947. Its first and, so

far, the biggest loan of $250 million was granted to France. The next lot of loans, aggregating $263 million, was for the Netherlands, Denmark, Luxemburg and Chile. They are to be repaid gradually over periods varying from 6½ to 30 years and bear rates of interest ranging from 2¾ to 3½ per cent. This is in addition to a uniform commission of 1 per cent which will help form the Bank's Special Reserve. According to its report for the year ending June, 1948 $525 million had in all been thus loaned out.

Almost all the loans are in U.S. dollars except in the case of Luxemburg, where the loan is in Belgian Currency, and Netherlands in whose case the loan is in Swiss Francs. They are meant, in the case of the European countries, for financing imports of capital goods and equipment needed for the reconstruction and rehabilitation of vital sections of industry affected by the war. In the case Chile, the loan is intended to aid in hydro-electric and agricultural development. Other members have also applied definitely for loans, or are conducting preliminary negotiations with the Bank.

In July 1947, the Bank launched in the United States two series of bonds, one with a maturity of 10 years and the other with a maturity of 25 years, the amount of the issues totalling $ 250 million both being heavily over-subscribed. Again in May 1948, another series of such bonds of 17 million Swiss Francs was placed upon the Swiss Market to the value of 17 million Swiss francs, the entire issue being taken up for investment by the Bank for International Settlement. This is some earnest of backward or undeveloped countries getting substantial aid from this Fund; and India may well hope to benefit from it in regard to her programme of planned development of all her latent resources.

The second Annual Meeting of the Boards of Governors of the Fund and the Bank in 1947 decided that the original quota in the Fund, and the subscription to the capital stock of the Bank of the undivided India should continue to be the "quota" and "subscription" of the new Dominion of India.

VII. Cessation of Rupee as Legal Tender

With the cessation of the legal tender character of the standard coin with effect from November 1, 1943, the quaternary rupees, issued from December 1940, upto the end of May 1946, nickel rupees issued from June, 1947, and the Government of India one rupee notes, constitute as from that date the total amount of rupee coin in circulation. Their aggregate circulation stood at Rs. 123.81 crores at the end of October 1943. The circulation of rupee coin rose to Rs. 137.33 crores at the

end of 1943-44 and to Rs. 147.38 crores at the end of 1944-45. By the end of the war, the total absorption of legal tender currency was 1198.64 crores of which notes totalled 988.89 crores, 82.5%, rupee coin 142.16 crores or 11.9%, small coin 69.59 crores or 5.6%. The total rupees in circulation at the end of 1947-48 was 155.33 crores; the record being in 1946-47 at 167.67 crores.

While the metallic coin continued to be in demand in the interior, a marked partiality for the more convenient and handy rupee note became popular in urban areas. The issue of one rupee notes, however, was restricted, so that the demand for quarternary rupees has gone up. At the end of March 1948, the proportion of the Notes of several denominations is given in the Introduction.

The demand for small coin continued unabated throughout the War. At one time there was an acute shortage felt in the principal cities, and greater quantities were minted and absorbed. The absorption of small coin during 1944-45 amounted to Rs. 19.20 crores as compared with Rs. 18.46 crores in 1943-44, Rs. 11.64 crores in 1942-43, Rs. 5.06 crores in 1941-42 and Rs. 2.21 crores in 1939-40. In 1946-47 Rs. 5.91 crores of small coin were absorbed while in 1947-48 the figure was still lower at Rs. 3.98 crores. It accounted for 31.3 per cent. of the total absorption of Rs. 67.89 crores since September, 1, 1939. The tendency is very marked towards declining absorption of new small coin.

K. T. SHAH.

APPENDIX

MEASURES TO FIGHT INFLATION

While these pages were going through the Press, Government announced their broad general policy in regard to the still unchecked rising spiral of prices. They have taken Fiscal as well as Financial aspects of the situation into consideration, no less than direct incentive to increasing production, and rationing and control over distribution for the essential commodities of life.

On the financial side, the most urgent need is to fill up the budgetary gap between revenue and expenditure, both in the Centre and Provinces from next year, and effort should be made to bring about surplus Budget all over the Union. A Cabinet Committee is set up to carry out an urgent review of all Development plans, both Central and Provincial, and to determine the relative priority of accepted Development schemes, so that expenditure on non-productive schemes might be deferred or curtailed. Lest inopportune haste in social reform should sabotage the Plan, the Provincial Governments have been warned that they could expect no financial assistance from the Centre in implementing their plans for the abolition of Zamindari or for Prohibition, which might either involve excessive borrowing, or unbearable loss of revenue. To meet the present deficit in some Provinces, the latter are advised to strengthen their finances by the levy of an Agricultural Income Tax where it is not now levied. In cases, however, where the Land Revenue is a more direct charge of the State on the tenant, and so requires assimilation with the Income Tax some loss may have to be faced on this head, which may not all be made up by levying a surcharge on all land revenue payments above a given figure,—say Rs. 200/- per annum. The progress of the Estate Duty Bill, now before the Central Legislation, will also be expedited. But even if passed before next March, it is doubtful if the proceeds from that source would be available in 1948-49.

As regards prices, the policy of decontrol, adopted last December, was reviewed, and the revised policy of control on foodgrains and textiles has been announced. This is intended to secure an equitable distribution of foodgrains and cloth at reasonable prices well below the existing levels. After long consideration Government decided not to reintroduce ration-

ing in sugar, but they are taking steps to reduce its price. They also would adopt measures to secure better distribution of essential commodities like kerosene, iron and steel and cement.

Government consider one of the main causes of the present crisis to be the existence in the hands of large sections of the community of purchasing power far in excess of the available supply of goods. It results in a progressive increase in prices. This position will improve if the public invest more in Government loans and in savings schemes. In order to stimulate investments Government propose, in co-operation with the Provincial Governments and States, to intensify the campaign for small savings. They have also decided to afford wider facilities for investments by the small investor in post offices. The maximum permissible limit for investments in postal savings banks will be raised from Rs. 5,000 to Rs. 10,000 and in National Savings Certificates from Rs. 15,000 to Rs. 25,000. Treasury Deposit Receipts will be issued on favourable terms for 6, 9 and 12 months to cater for institutional investors seeking short term use of their funds.

Concessions to Industry. In the field of industrial production, Government consider special steps are necessary to stimulate production. They have, therefore, decided to grant the following concessions:—

Firstly, the present rules regulating allowance of depreciation on plant and machinery for Income-tax purposes will be liberalised. This may mean some loss in revenue; but it is worth while incurring if the main problem is to be satisfactorily tackled.

Secondly, new industrial undertakings will be exempted from income-tax for a specified period.

Thirdly, raw materials and plant and machinery, imported into the country for industrial purposes, will be granted such relief in Customs Duty, as would not injure Indian manufacturers of similar goods.

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(Report of the Sub-Committee)

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CONTENTS

INTRODUCTION

I. Terms of Reference

This Sub-Committee was appointed to deal with:—

(a) The present and prospective scale of expenditure by National as well as Provincial and Local Governments, and of the several States.

(b) Their sources of income through taxation, and income from public domain, public enterprise, and other receipts.

(c) Incidence of these burdens.

(d) Development of new sources of public income with a view to aiding the process of planned development, and effecting redistribution of national wealth.

(e) The Sub-Committee will suggest the maintenance and development Budget for each State and Province to assist effective carrying out of the Plan, including the utilisation of Public Credit.

Since this Reference was made, the economic, financial and political conditions and circumstances of the country as a whole have been so radically altered that it is impossible to outline any dependable picture of the country's financial position and possibilities, with particular regard to the use of Public Finance in carrying out a nation-wide comprehensive plan of progressive development. Six years of a World War cannot but leave their mark on the public economy of any country, and much more so on the national economy of a country which had made War effort on the scale that India had done. But quite apart from this, the country has ceased to be a dependency of Britain, and attained, virtually speaking, her national independence, which cannot but affect vitally and at the very root her financial system, and its capacity to help in carrying out a comprehensive National Plan.

Then again, the country is no longer one, as it was under the British domination. Large areas and populations have been partitioned off, resulting in large scale loss of material wealth, and dislocation of millions, whose rehabilitation and

resettlement create entirely new strains and stresses in our national financial structure.

The century old distinction, moreover, between Provinces and States, with their different revenue and expenditure systems, is fast disappearing, most of the so-called pre-Union Indian States are either merging into adjoining territories called Provinces, or forming unions and groups of themselves to rank as new units, or component parts of the Union, on a par with the existing Provinces. The problem of selecting and dividing tax-resources and reapportioning expenditure between the Union and its component parts, old as well as new, has become materially complicated and different since the Government of India Act of 1935 was passed, and the above Terms of Reference were devised on that background. As will be shown more fully hereafter, the nature, number and yield from the several sources of Revenue have altered beyond recognition during six years of war and two years of political turmoil.

At the same time the demands on the public purse, not only to take up energetically programmes of moral and material development which had been hitherto neglected, but also to uphold the country's independence, are growing so rapidly that the background of 1939 is no longer applicable. Indian planners can no longer think of National Defence, for instance, even on its financial side, in a light they considered it when India was part of the British Empire. This item is, consequently, growing as much because of the inherent reasons of scientific developments in armament as well as strategy of war, as of political entanglements. The obligation, again, to bring up to a common or comparable level the stage of administration efficiency; and social service in relatively backward areas which were formerly Indian States will bring its own additional burden. The task of material as well as cultural progress under a National Plan of all round growth and expansion must mean yet further strain on the country's finances, which in course of time will more than neutralise itself. Not only have the available human resources and material not been fully known, explored or exploited; much has been passively neglected or actively suppressed, lest the process of alien and imperialistic exploitation be impeded by the growing national consciousness of their own dues by the children of the soil, or the increasing understanding of the demands of social justice may precipitate industrial unrest or class-war. Under these conditions and circumstances, the problem of Public Finance has to be viewed in a wholly dif-

ferent light than was placed before the Sub-Committee. That body, it may be added, had not completed its task in its entirety as much because of lack of time and data, as because of the silent revolution, just indicated, which had already set in.

II. Place and Function of Public Finance in Planned Economy

To allot to Public Finance its proper place and share in a programme of a country's planned development, and to make it discharge the functions that may legitimately be expected of this instrument of economic reconstruction and social jusice, we must begin by defining and understanding the nature, scope and function, of Public Finance in the national economy of a country. The expression,—Public Finance—is commonly used to include not only the recurring income, collected by the State from all sources by means of taxes and other forms of revenue to meet the accepted obligations of Government upon the public purse, but also the utilisation of the collective credit of the community to meet sudden emergencies and aid in the formation of new wealth; and thereby to ensure a better standard of living for the community as a whole, and for every individual comprised therein.

Thus conceived, Public Finance becomes a most powerful instrument, collectively used, not only to maintain the integrity and independence of the country, but also to secure its progressive development of its material resources and spiritual welfare of its people. A good deal, if not the entirety, of this view being justified depends upon the accepted notions of the nature of the State, and the duties of Government. These notions have varied immensely in the course of our social evolution.

Perhaps the earliest expression of the collective life and organised effort in a civilised community was to be found in the patriarchal State, wherein the Head of the organisation, for the time being was responsible for the welfare of the entire organisation. To him, therefore, were due the allegiance and obedience of every member of the community. The scale, however, on which Patriarchy obtained must have been very limited, in number as well as extent. In primitive times, therefore, with very few wants and resources, this form may have worked quite satisfactorily. Active promotion of the well-being of the individual and the energetic development of the material resources of the community as a whole, could

not have occasioned so much stress or anxiety to the ruler, as fall to the lot of his present day more sophisticated successors.

A variant of this form of Government, familiar even in modern times, is Benevolent Despotism. Here also, the responsibility rests alone with the ruler, or the head of the State, to ensure the well-being of the masses under him. But the conception of what constituted their welfare, individually or collectively, was the despot's own; and he discharged it in accordance with his own light. There was none to counsel, none to guide, none to check him nor share his responsibility, even though there may be hundreds and thousands to do his will. Being practised on a much larger scale than Patriarchy, and affecting far larger numbers, such a despot's work may result in weal or woe to large numbers, without his ever realising what were the consequences of his effort.

In so far, moreover, as such a despot was himself a member of a class within the community, and had all the sympathies and antipathies of that class, e.g. the King and his noblesse, uniform attention to the welfare of all members of the community was apt to be neglected in preference to the welfare of a class or a section. Benevolent despotism to be really beneficial to all members of the community concerned alike must see to it that the Head of the State stands apart, utterly unconnected with any section of the community, and having no ties, no interests or desires except the well-being of the people as a whole. Being restricted, moreover, to one man, the ability of this form of social organisation to develop unknown resources and progress in unexplored fields of social justice and individual liberty would be impossible. One individual, however gifted or inspired, must necessarily be limited in his effort in a dynamic State, which, to be successful, requires the whole-hearted co-operation of every part of the body politic.

While Patriarchy and Benevolent Despotism may be unable, by the nature of their constitution, to take active steps in developing the material resources and promoting the spiritual welfare of the individual in a country of the size of India, Democracy of the Parliamentary variety may have its own handicaps for functioning more actively in the promotion of the welfare of the individual. Executive responsible to a large number representing a variety of interests,—each member feeling himself part of the Sovereign authority in the State is apt to be slow in procedure, and weak in performance.

While the **Laissez faire** view of the State and its function held the field, and Government was restricted to the maintenance of law and order within the country, and its integrity and security against foreign aggression, Parliamentary Democracy may have proved successful. In a country like Britain, where this type of Government has had the most satisfactory record, the attitude of the State to its members was for a long time one of non-intervention. State activity being confined only to police purposes and defence, ideals of peace and economy by doing nothing would flourish and make democracy an impressive appearance, if not an objective reality. Tradition and convention had, since generations, determined, in that country, the limits of such interference as there was. in the daily life of the citizen, which were observed by both the principal political parties. But these have begun, only in the last generation or so, to recede in the background yielding place to the modern conception of the State, in which collective effort, agreed upon by common consent, tends to attend to individual concerns as much as to the collective security of the country.

Parliamentary democracy, however, has evolved in Britain itself, since the days when the country was yet not unified, and the Empire unborn. The numbers were limited, enterprise restricted, individual consciousness of social justice dim and passive. Only two political Parties shared alternately the responsibility of governing the country and the Empire; and they both had essentially the same ideals of government, the same view of the functions of the State, the same touching faith in the efficacy of enlightened selfishness of the individual accomplishing as effectively the good of the individual as of the State. As applied to a country much larger in size or numbers, the counsels of hundreds failed to preponderate on a definite course of action; or even if agreed to for a while, could persevere in it for sufficient time to make long-range effort bear fruit. Groups were formed which frequently coalesced but always remained distinct, which always divided but never shared political power. Political action was still further weakened, because the outlook was so varied. There could be, and often was, difference even on the fundamental principles of government and the basic ideals of the community. And planning is essentially long range, wherein the interests of the country as a whole, as well as every individual therein, have to be promoted by disciplined effort of millions, carefully co-ordinated and scientifically applied, a systematic exploitation of the resources and development of its possibilities in all directions of moral and material welfare. In a

Parliamentary democracy, therefore, unless a strong Party with overwhelming majority takes charge of the country's destinies with a firm hand and keeps hold of power for a reasonable period, and, at the same time, steers rigorously clear of the danger of degenerating into Dictatorship of one individual or a small coterie, the ideal of planned economy, as defined at the very outset of the work of the National Planning Committee, would be impossible to realise.*

The National Planning Committee thus seems to have accepted the democratic system as the foundation stone for framing as well as giving effect to the Plan. The country's independence having been achieved, and popular sovereignty having been established, the preparation of the Plan,—and, **a fortiori**, its execution,—become a matter of urgent importance. In the definition of planning quoted above the co-ordination of endeavour in all sectors of the national economy, at every stage, and in every item, is made the essence of scientific planning. To achieve this in India on a country-wide scale,—with needs and resources, temperament and tradition varying from unit to unit and region to region,—will require a concentration of authority and initiative, of discipline and co-operation, of a sense of national solidarity and individual liberty, of social justice and political integrity, which are difficult to maintain in what is popularly known as Democracy, even in the form of parliamentary responsibility of the Executive. There will have, therefore, to be a clear demarcation of power, function, and obligation, as between the various units and the Central Government, without which a scientific Plan would be difficult to evolve and still more difficult to implement.

Public Finance, is the key to such evolution and achievement, and, as such it will be all the more difficult to organise, re-adjust, and utilise. Judging from the Resolutions passed by the National Congress, successor to the British Government in India; judging from their election manifestoes and official declarations of policy, the State in India, whatever its form as a polity, must function as the organised representative of the community, closely interested and concerned in all that relates to the safety, security, integrity of the nation as well as with the discovery and development of its resources, and

* "What is planning?" asks the Note for the Guidance of Sub-Committees. "Planning, under a **democratic system**, may be defined as the technical co-ordination by disinterested experts of consumption, production, investment, trade and income distribution in accordance with social objectives set by bodies representative of the Nation."

the promotion of the spiritual and material well-being of all that dwell within its limits. The effete and obsolete "police man" theory of the State will no longer serve to meet our needs. Accepting this basis of the State in India, Finance must be taken to be the keystone of the entire structure of our national economy. It must not only hold together the various parts of the system, strengthening and supporting the weak, encouraging and developing the strong; it must also aid in an active programme of national regeneration, which had been held up or impeded by alien interests or local ignorance, apathy, or lack of skill and enterprise. The State will have to embark, as early as possible, on a constructive programme of planned development in every sector of our national economy. Pending, however, the reorganisation of our Public Finance to a pitch where it would effectively function in that guise; pending, that is to say, the utilisation of the Public Purse as an instrument of national reconstruction and progressive advance to a point where poverty would be banished and unemployment impossible, where no available or potential resources would be left unknown, unexplored, or undeveloped, the machinery of Public Finance,—both Revenue and Expenditure as well as Public Credit, should be used to redress the uneven and uneconomic distribution of national wealth,—new as well as old.

Public Finance is thus of the utmost importance in a well concerted plan of national development, in all activities, in every facet of the life of the country. But it does not function as a mere mechanism, or an inexorable force of nature. It is not anything outside the ability of the people, once they have become an independent sovereign nation by themselves, so to design the financial structure and order its working as to aid actively in the main task of planned development. It is a creation of their will and functions in accordance with it.

As mentioned more than once before owing to alien interests holding sway and moulding the country's economy to suit their own requirements; and owing also to the peculiar turn given to National Economy by their conflicting requirements, the inherent resources of the country were either left undeveloped or if developed they were so developed that they hindered rather than helped as rapid a growth as could be desired. It was taken as a maxim of British policy in India to interfere the least with the country's customs and habits or institutions. Their financial system was so designed as to bring to the treasury the maximum of yield with the minimum of interference in the economic life of the people. Hence it

was that Finance was administered by them merely as a handmaid of their Empire rather than as an active factor in developing the Dominion.

For instance: Industrialism was born in the West a century before its beginnings appeared in this country when the governance of the country had just passed to the British Crown. These early steps in modern Industrialism were taken in India under the mistaken and selfish policy of **laissez faire.** The British Government of India refused to consider that this industry was new and in unfamiliar hands. They declined to accord any protection or assistance to the infant industries of this country, which had got to compete with the far more developed corresponding industries of Britain. Even in the new developments, which Scientific discovery or mechanical invention had brought in the nineteenth and early twentieth centuries, while this country was ready to accept, e.g. Railways, Telephones, Printing Presses, Textile Mills or Armament Factories, the production of the basic requirements of these very industries was not introduced in India at the same time. India was, therefore, dependent all through the British Rule for all essential requirements of her new industries, services or utilities on foreign supply, and the progress of economic development which could be achieved with their aid was necessarily slow and secondary.

After the War of 1914-18, a beginning was made in the direction of a New Fiscal Policy of "discriminating protection." Suitable industries, which were pronounced appropriate for such protection by a special detailed investigation, were selected for such protection, import duties being imposed to neutralise the force of competition Several industries have come to obtain fiscal protection under this policy in the last 25 years; but their growth has not been as rapid, as intensive, except in a very few cases, as to meet the entire local demand, or use up the entire local output of raw material for building up of such industries.

In no less important departments of national development, like Education, Health, or other Public Utilities and Social Services, such development as has occurred in the last days of the British Rule in India, was mostly unplanned and unco-ordinated, or so ordered as to leave out the essentials and provide the superficials for the country's new life. The strain on orthodox Public Finance, as handled by the British Finance Ministers of India was growing and unmistakable. But it was still conceived and used as a mere mechanical aid

only, and not a consciously devised agency to achieve predetermined objectives. It is to correct this, to reorganise the entire machinery and objective of Public Finance, that New India, whether a Dominion or an Independent Republic by herself, will have to re-shape its financial policy and system, both on the revenue and expenditure side, so as to make up the lee-way that has occurred in the past, and speed the country forward on new incentives to new objectives, new technique and new ideals to realise predetermined ends which the National Planning Committee has, from its beginning, placed before the country. If the country is united, and its new Democracy able to recognise and shoulder the responsibility that lies before it, financial impediment cannot, and must not, stand in the way of any programme of all round national development—such as has been outlined in the various volumes in this Series,—being carried into effect. For, in the last analysis, Public Finance is a means subservient to a nation's will. Once that will is clearly and unambiguously expressed; once a Plan of the kind envisaged in this Series has been prepared and ready for execution, finding the required funds or the necessary finance, would be only a matter of proper organisation and careful co-ordination of resources and obligations. This would in fact apply to all the prerequisites, conditions and circumstances for preparing and carrying into effect a nation-wide, overall Plan. To Public Finance, however, as the most potent instrument of executing the people's will, this would apply with special force.

In the case of Finance, whether in the shape of productive capital needed for long-range investment, or for current needs in the shape of specific grants to particular objectives made from tax collections or industrial enterprises or other revenue resources, the reorganisation would very probably involve complete re-drafting of the Revenue System, and wholesale reconditioning of the Expenditure. The former was once attempted 25 years ago by the British Government, and was once again promised by the last of the British Finance Ministers of India. The latter was attempted by the Inchcape Committee even before the former. A fresh review of Public Expenditure, Central and Provincial, in all branches of such expenditure, not only with a view to cutting down useless outlay, but also with a view to proper economy in using the Public Purse so as to obtain the best value from every pie of public money spent. The replanning of the National Credit system, so as to anticipate future wealth of the community would likewise have to be redesigned, reconditioned, and re-employed on a wholly new basis.

With such a conception of the nature and function of Public Finance it is obvious that the first step in planning Public Finance would be to make it an integral item in the overall National Plan, and use it for giving effect more intensively to the Plan. The Report which follows indicates the new form and possibilities of Public Finance as part of a National Plan.

III. Distinction Between Public and Private Finance

At this point it is necessary to clear one misunderstanding that commonly obscures or distorts the place of Public Finance in the country's Economy. The distinction that is usually made between Public Finance and the rest of the financial aspect of the country's economic life is the heritage of days when the function of the State was not coterminous with the life of the people, but limited to what we have called above the duties of a policemen, namely the maintenance of order, enforcement of law, and provision of defence against aggression. This was the belief commonly held in Europe about the time the Government of India passed directly to the British Crown. This view, therefore of Public Finance and its uses was accepted by the Government of India, and worked upon in this country. Here it was further intensified by the fact that the Governors of the country were alien, and were believed to be antagonistic to the long-term interests of the country as a whole. Government, therefore, necessarily confined their demands for funds to what was absolutely necessary for their maintenance. All that was required of the people was considered by the people as so much exaction; and nobody considered it to be a serious offence to evade these burdens of Government by every means in the power of the tax-payer.

But even in those days the oustanding distinction between public and private finance was that in the former the decisive dominating factor was Expenditure to which revenues had to approximate, while in the latter it was the available resources or income which set the standard for expenditure. That all revenue collected by Government from any source whatever is, in the ultimate analysis, part of the aggregate wealth or the gross production within the country which is compulsorily deducted for the public use before the producer or owner can enjoy it. To pay one's taxes as part of one's social obligations was a conception impossible to act

up to while foreign domination and alien exploitation distorted our view regarding the relation between the citizen and the State. Now, however, that that great handicap is removed, now that the people are, theoretically at least, masters of their own destiny, this obscuration of the real nature and proper use of the resources of the public purse, as well as of all forms of public outlay should not be continued any longer. The National Budget should be viewed as, not merely the receipts into and disbursements from governmental treasuries, but rather as the sum total of all kinds of production,—new wealth or otherwise,—whether actually formed or in anticipation, and its outlay for the benefit of its people, whether by promoting material production or developing Social Services, Public Utilities and Cultural Activities. The agency which levies, collects, controls, and utilises the largest portion of the national wealth must be treated as the common trustee and the national mandatory. The Central Government of the country, or the Governments of the various units or of the various Local Authorities, Statutory Corporations, and other public or semi-public bodies that make up the totality of the Government Machinery, together they get together funds sufficient to carry out their immediate obligations, and so use the resources placed at their disposal as progressively to develop all available resources, stimulate all helpful, beneficial activities and promote the spiritual as well as the material welfare of the people.

In a planned economy, particularly, this view of the National Budget and Public Finance as part of the country's total resources and utilisation is indispensable, if the Plan itself is to be held in proper perspective, and its execution adequately and effectively assured, governmental agency would then be regarded as the best and the most economical channel for collecting a part of the wealth of the community which is surplus after all legitimate needs of the individual are met or whatever is necessary for the obligations assumed by Government, to promote the welfare of the people under its charge, and stimulate the economic machinery of production and distribution to the best of its ability. Taxation, instead of appearing as a compulsory and inexplicable deduction from the wealth of the individual, to be used for purposes he neither knows nor approves, would be replaced by a share to the State out of the new, additional wealth produced by the help of its planning, organisation, and initiative; while expenditure would be regarded, as a return to the individual, in the form of obvious services and measurable benefits of Government, of what was levied from him or his fellows in the shape of

taxes. No part of the country's resources would be spent,—except on the defence of its people and the promotion of their welfare, within the country itself.

IV. Public Finance—A Means of Redistribution of National Wealth

Pending, however, this revolution in the popular attitude towards public burdens and benefits received from the activities of Government; and pending the full fruition of the Plan this Series envisages, Public Finance will have to be designed and operated, so as to promote the main objectives of the Plan, and remedy the inequalities that now disfigure the social system. Taxation and Public Expenditure, as a means of redistributing the national wealth, have been increasingly utilised in recent times by all states, even when those who use it do not admit any such purpose to guide their measures or dictate their policies. But as soon as the "Policeman" conception of the State, its functions and responsibilities, are widened to include an active share and direct initiative in the promotion of the material and cultural well-being of the citizen, the demands of the taxing authority would necessarily be recognised as a means to re-adjust the inequalities of wealth distribution in possession or prospect, in the imposition of the burdens of government.

This would inexorably lead to the burdens of the public demand of taxes or other revenues being placed more and more on the shoulders that are calculated the most easily to bear them. Conversely the benefit of all public activities, paid for from the Public Purse, must be apportioned or made available to those who need them most. Even if, as a logical conclusion of this theory, taxation goes to the limit of taking up the entire surplus wealth, whether income or capital,—of an individual or a corporation, after providing for the needs of such individuals and corporations on a predetermined basis, there could be no ground for just complaint, provided the expenditure incurred and defrayed out of such collections is exclusively for the immediate or ultimate benefit of the people. No part should be spent outside the country; no benefit should result, except to the children of the soil.

The use of the national Budget to rectify the inequalities of distribution of the wealth of a community, founded on private property and functioning under the impulse of the profit motive, applies not only to the wealth **in esse**, but also to wealth **in posse**. That is to say, the Credit machinery, or the

borrowing powers and capacity of Government, could likewise be utilised, and must be so utilised, to effect a gradual redistribution of the community's wealth on a more just, more rational basis. The production of new material wealth, or the promotion of the indispensable social services, cultural amenities and public utilities, which make all the difference between those who have and those who have not, between the favoured and the privileged, and the disinherited, oppressed or exploited, may require anticipation of future wealth, just to supply those tools and implements, materials and labour, skilled and with efficient management, and scientific guidance, without which no production can take place, and the wealth of the community cannot be increased. The burden of such anticipation should, likewise, fall only on such shoulders as can most effectively bear them, though a scientific organisation of the machinery of Credit, its institutions and instruments, would make the "burden" least felt. The fruits of such enterprise, on the other hand, must be distributed according to a plan, which would go still more to undo the prevailing inequalities.

As pointed out already, it is possible to achieve several objectives by a proper use of Public Finance in regulating the normal economic life of a community, and effecting re-distribution on a more equitable, if not equal, basis the available wealth of the country amongst its people. It can aid actively in developing the potential resources of the country, and thereby improve the standard of living and conditions of work all round.

Much of this can be accomplished by a proper husbanding of the resources which Government can dispose of. They consist, in a society based on private property and actuated by the profit motive, mainly of taxation. These receipts may be supplemented by Fees for services rendered, or Prices for commodities supplied. Profits of such enterprises as the State carries on directly by its own agency, on a commercial footing, Rent, Royalties, or other analogous income from Public Domain make, in modern times, an increasing item also on the revenue side of the national or local Budget. The last category may be relatively unimportant in a society of the kind now under consideration; for in such a society as most of the enterprises that the State handles directly are not handled with an eye to surplus or profit, but rather with a view to benefit and render service to the community as a whole. If there is at any time any monetary surplus, it is used in reducing charges, or improving the quality of the commodity supplied

or service rendered or the salaries and wages of the staff employed or the conditions of their work. The value and utility of such enterprise is measured by the volume of benefit received or service rendered, and not by deriving a monetary surplus by the State or its Agent like a Statutory Corporation, or a representative like a local body.

Even as regards Fees for services rendered, or rates for Public Utilities or other such public enterprises, they are made as near as possible, to correspond to the cost of providing, maintaining Departments which offer such services, and not with a view to make any net profit for the Exchequer out of these. Examples may be found in cases of fees for Passports, or rates for Postal, Telegraph and Railway Services. In India, however, the last mentioned items cannot be said to be entirely free from any element of profit-seeking. Being public monopolies of most widely used services, they have been utilised in every moment of crisis, and particularly in the last decade, as fruitful means of making up the Budgetary deficits. But the policy of increasing postal charges and railway rates or fares, by a direct increase or levying surcharges is open to a serious objection that they needlessly burden communications and hinder trade. Those who follow such a policy also overlook the elementary canon of such taxation, viz. that the higher the rate the lower very likely would be the yield. The law of Diminishing Returns may not have set in already as there is still immense room for expansion in these services and utilities in India. But the policy is apt to defeat the principal aim of such increases, and the Budgetary gap unlikely to be filled.

It is only, therefore, by Taxation, direct as well as indirect, that the bulk of the resources of the State are or can be obtained under the present social order for rendering such service and discharging such other functions as the State may impose upon itself from time to time.

V. General View of India's Financial System

On this background, let us now examine the place and function of Public Finance in India under the British Rule as observed elsewhere, the State in India functioned largely on the orthodox theory which least interferred with the daily life of the people. On that basis the following Table gives a general view of the Financial System from 1937-38 to the latest Budget proposals, including both Central and Provincial Budgets:—

TABLE I

(In Crores of Rupees)

Year	Revenue of the Central and Provincial Governments in India — Revenue Central.	Provincial.	Total	Expenditure of the Central and Provincial Governments in India — Expenditure. ***Central	***Provincial	Total.
1937-38	86.61	89.44	176.05	86.61	86.95	173.56
1938-39	84.52	84.74	169.26	85.15	85.76	170.91
1939-40	94.57	90.83	185.40	94.57	89.22	183.79
1940-41	107.65	97.48	205.48	114.18	95.18	209.36
1941-42	137.57	107.41	241.98	147.26	103.48	250.74
1942-43	176.88	124.31	301.19	289.05	118.18	407.23
1943-44	252.06	163.31	415.37	441.84	153.85	595.69
1944-45	335.57	208.18	543.75	496.71	204.28	710.99
1945-46	360.67	229.33	590.00	484.57	218.14	702.71
1946-47	336.19	243.07	579.26	381.48	254.65	636.13
1947-48	178.77	207.04*	385.81	185.29	211.08*	396.37
1948-49	255.24	**242.77	498.01	257.37	258.27	515.64

** Including new Taxation.

*Includes figures of West Bengal's Budget estimate for 1947-48.

Source:—Figures for 1937-38 to 1946-47 from Table 15. p. 65 Report on Currency & Finance 1946-47 issued by the Reserve Bank.

Figures for 1947-48 and 1948-49 from Table 16 p. 74 Report on Currency and Finance 1947-48 issued by the Reserve Bank.

***According to the Report of Expert Committee on **Financial Provision of Union Constitution** pp. 26-27, the aggregate deficit in the Central Budget was Rs. 650.78 crores between 1937-38 and 1946-47-(Budget). This was increased by Rs. 8.65 crores according to the estimates of 1947-48 and 1948-49. The Provincial Governments had in the 11 years between 1937-38 and 1946-47 an aggregate net surplus of Rs. 51.95 crores and built up their total Reserves to Rs. 95.91 crores.

Taking all the Revenues collectively, the following Table shows the growth in recent years of the aggregate revenues of the Central and Provincial Governments in India duringthe last 15 years.

TABLE II

Distribution of Revenue
(In Crores of Rupees)

Year	Tax Revenue (a)	Cost of Collection	Net Tax Revenue	Net Revenue from Commercial Departments	Opium Receipts less expenditure	Currency & Mint. Receipts less expenditure	Interest Receipts	Other Revenue	Extraordinary Receipts	Total Net Receipts
1933-34	72,97	-3,31	69.66	56	88	74	1.63	2,72	35	75.43
1934-35	78,08	3,51	74.57	33	37	75	2.01	2,72		80,75
1935-36	77,35	3.64	73,71	4	27	75	87	2.73		78,29
1936-37	74.96	3.77	71 19	1	19	81	40	3,12	1	75,71
1937-38	73,14	3,29	69.85	3,25	26	38	59	2,93	3,93	81,19
1938-39	72.34	3,75	68,59	1.47	25	22	74	3.16	4,06	78,49
1939-40	79.06	3,40	75.63	5.11	23	88	76	3,00	3,16	88,83
1940-41	75,50	3,34	72.16	13.34	24	96	79	3,38	10,58	1,01,37
1941-42	95.87	3.98	91.89	23 50	41	2,17	67	3,44	4,90	1,26.98
1942-43	1,23,61	4,47	1,19.14	24,58	26	3 50	86	4,26	16,44	1,69,04
1943-44	1,70,23	5.15	1,65.08	46,61	— 2	7 70	1.62	4,29	15.43	2,40.71
1944-45	2,52,81	7,11	2,45,76	42.18	— 5	10 38	1.78	5,41	18,78	3,23,24
1945-46 (revised)	2,82,67	8,04	2,74,63	42,52	—51	15,22	1.61	6.09	9,14	3,48,70
1946-47 (budget)	2.39,13	8.11	2.31,02	17.12	8	15.18	1,30	34,50	7	2,99,27

(a) Excludes share of additional revenue from import and excise duties on motor spirit payable to Road Development Fund from 1928-29.
Source:—Annexure I. Explanatory Memorandum on the Budget of the Governor-General in Council for 1946-47.

These are revenues of undivided India upto the Budget for 1946-47. The following Table shows the principal components of the total Central Revenues for the Union of India according to the latest Budget i.e. for 1948-49:—

TABLE III

Revenue Estimates

(In crores of Rupees)	Budget 1948-49
Customs	81.75
	— 58*
Central Excise Duties	34,00
	13.10*
Corporation Tax	39,50
	10,30*
Taxes on Income other than Corporation Tax	90,50
	— 3,92*
Salt	(a)
Opium	1,40
Interest	1,17
Civil Administration	5,12
Currency and Mint	9,40
Civil Works	81
Receipts from Indian States	—
Other sources of revenue	4,36
Posts and Telegraphs:—Net contribution to general revenues	38
	40*
Railways:— do.	4,50
Deduct—Share of income tax revenue payable to Provinces	— 37,87
	— 1,96*
Total	2,35,02
	21,26*
	2,56,28

(a) Included under "Civil Administration."

* Effect of Budget proposals.

Source:—Explanatory Memorandum on the Budget of the Central Government for 1948-49.

Characteristics of the Revenue System

Examining the salient characteristics of the Revenue system in India, the first feature that strikes us is the growing shift in emphasis on the different forms of Public Revenue. In the past, from the beginning of the direct British rule in India, when Public Finance came to be regularised and modelled on the British System, the sources of Revenue were limited, the chief of them being that from land. The Government of India was then a wholly unitary body, and all revenues were that of the Central Government. The Provincial Governments which existed then were wholly subordinate and mere agents of the Central Government. They were advanced such sums as were necessary for expenditure incurred in the various divisions of the country, but defrayed by the officers or from the treasuries of the Central Government of India. All revenues on the other hand, wherever collected, belonged to the same Central Authority.

Decentralisation began in 1870, and was carried out by regular stages of Quinquennial Settlements with the Provinces. By the time World War I had broken out, these Settlements had become semi-permanent and stereotyped. There were considerable variations, no doubt, as between the several Provinces, in the matter of resources placed at their disposal or obligations imposed upon them. But they all followed the same pattern; and the constitutional position remained unchanged till 1920. With the advent of Dyarchy, there were some modifications; but it was left to the days when 17 years later, Provincial Autonomy came into the country, that the Provincial Purse was wholly separated from the Central. Though there are even after 1937 certain common sources of revenue, or sources which are shared by all,—the Centre and the Provinces as well as the States, e.g. Income-tax, or Central Excises, on the whole the more important items are separate and distinct. There is similarly a division in the heads of expenditure, with the practice of Central Subventions, or Grants to the Provinces which remind us of the original position and guiding principles of Indian Finance.

In the latest phase of Constitutional Reform, however, there seems to be a tendency to assign to the Centre more resources, and those more capable of expansion or addition than to the Units. A fuller explanation of this departure from tradition is given in the Summary of Developments. It is unnecessary, for the purpose of this Introduction to go into

the latest proposals for the division of functions and resources as between the Centre and Units under the new Constitution for the Union of India. The fact, however, remains that, in so far as the actual administration and governance of matters that closely relate to the daily life of the people is necessarily in the hands of Unit Governments or Local Bodies functioning under them, the resources placed at their disposal are inadequate to the responsibilities similarly imposed upon them. If the Lincoln ideal of government of the people by the people for the people is to be realised in practice, it cannot be denied that the greater the resources available to the Units, the greater would also be the opportunity for them to do their work well.

As for individual items, since the beginning of Decentralisation in finance, Land Revenue was made over to the Unit Governments. Other sources of revenue have been either divided completely or been shared between the Centre and the Provinces. Various rights have, at the same time, been reserved to the Centre for dividing any revenue item or share so divided or laying down the general fiscal and financial policy, or making specific grants and subventions from the Central Purse to the Units.

Land Revenue, however, was a form of Direct Taxation which, all through the latter half of the nineteenth century, held, pride of place in the Indian Fiscal System contributing more than half of the then total revenues of the State in India. Another form of Direct Taxation, namely that on Income, was introduced in the last quarter of the last century. It began at very low rates, and in a very restricted manner; and was, even at times, reduced or remitted altogether, to mark the prosperity of the Public Purse, or perhaps to indicate the bias of the governing class against taxing the wealthier classes. When first introduced, the Tax on Incomes did not take the place of that other great Direct Tax, viz. land revenue. On the contrary against the land revenue assessed on the landed class that class was exempted from the tax on agricultural income, and the exemption has continued right up to the present times. Proposals for an Agricultural Income Tax, to be levied and collected by Provinces has come under consideration by the Units, ever since Provincial Autonomy was introduced, and may, under the changed conditions to-day, very soon be implemented. Between these two forms of income tax a very considerable amount may be derived from that source. At the present time, however, according to the latest available statistics, there are less than half a million

Income tax-payers including companies, in this country, who have incomes of Rs. 3,000 or more per annum individually, as shown by the Table below.

TABLE IV

Number of Assessees to Income-tax. Total Assessment and Total Tax. (1946-47)

(Figures in lakhs of Rs.)

	Category	No. of Assessees	Total Income assessed	Income-tax including deduction at source
I.	Hindu undivided families	70,377	5750.88	598.4
II.	Unregistered Firms & other Associations	14,074	1378.20	150.60
III.	Companies & Others Assessable at company rates	6,561	14838.12	3869.00
	Total	4,47,405	484;48.76	6810.94

N.B. These figures are taken from a Table prepared by the representatives of the Reserve Bank of India for the Committee of Economists appointed in August 1948 to consider the Inflation crisis.

Figures in respect of salaried assessees do not cover all cases resulting in no demand on account of adequate reduction of tax at source.

The rate of Income-Tax rises fairly sharply at the higher levels as shown by the Table below. The rate was even higher in the Budget of 1947-48 for the whole of India, but has been modified in the last Budget for the Union of India for 1948-49.

Income.		**Tax at 1947-48 rates on *Total Income				Tax at 1948-49 rates on *Total Income			
		Wholly earned		Wholly Unearned		Wholly earned		Wholly Unearned	
		Rs.	%	Rs.	%	Rs.	%	Rs.	%
3,000	..	56	1.9	94	3.1	56	1.9	94	3.1
5,000	..	156	3.1	219	4.4	156	3.1	219	4.4
7,500	..	344	4.6	531	7.1	344	4.6	531	7.1
12,000	..	794	6.6	1,281	10.7	794	6.6	1,281	10.7
21,000	..	2,563	12.2	3,813	18.1	2,563	12.2	3,813	18.1
36,000	..	8,844	24.6	10,781	29.9	8,625	24.0	10,563	29.3
80,000	..	35,844	44.8	40,531	50.7	34,125	42.6	39,281	49.1
3,00,000	..	2,42,094	80.7	2,50,219	83.4	2,23,344	74.4	2,36,469	78.8
10,00,000	..	9,20,219	92.0	9,28,341	92.8	8,99,906	90.0	9,13,031	91.3
30,00,000	..	28,57,719	95.2	28,65,844	95.5	28,37,406	94.6	28,50,531	95.0

* Total income here excludes any income from Capital Gains, and is as reduced by the Business Profits Tax payable, if any.

Source: Explanatory Memorandum on the Budget of the Central Government for 1948-49.

**According to the Explanatory Memorandum (p. 6) accompanying the Budget for 1948-49:—

"Under Section 138 of the Government of India Act, 1935, as amended by the India Provincial Constitution Order, 1947, it has been prescribed that 50 per cent. of the net proceeds of taxes on Income, other than Corporation Tax and Central Surcharges, and the portion of the Tax attributable to the Chief Commissioners' Provinces and federal emoluments, shall be distributed among the Provinces as follows:—

Madras	18%	Bihar	13%
Bombay	21%	Assam	3%
Bengal	12%	Orissa	3%
C. P.	6%		
U. P.	19%	Total	100%
Punjab	5%		

The share of the income-tax revenues payable to Provinces is calculated as follows:—

	Budget of 1948-49		
Total Taxes on Income, other than Corporation tax. and excluding Central Surcharges ..	Rs.	87.25	Crores
Deduct—portion attributable to Federal emoluments, Chief Commissioners' Provinces and miscellaneous ..	"	— 5.89	"
Share of Cost of collection ..	"	— 1.12	"
Balance ..	Rs.	80.24	"
Deduct amount to be retained by Centre ..	"	42.37	"
Amount payable to Provinces ..	"	37.87	"

Tax Evasion.

The rates of taxation have been, in recent times, considerably and progressively raised. The Tax is a progressive charge rising in rate as the amount of income increases. There is a minimum of subsistence exempted from taxation and certain deductions are allowed in respect of expenses incurred for earning an income, depreciation of plant buildings and machinery etc. But no deductions are allowed from the income taxed on account of the number of dependants etc. It is unnecessary to go into the details of the variations in rates, as well as the methods of assessing and collecting this tax. It is claimed in some quarters that the Income Tax Collection Machinery is about as efficient in this country as anywhere else; and yet the belief prevails that at least as much taxable income escapes taxation as is charged to tax.

It is not denied that there is considerable evasion of tax payment in this country as elsewhere. But that evasion is due rather to the lack of a correct public sense or appreciation of the ethics involved than to any defect in the system of assessment and collection. No one can say what is the total amount of tax payment thus evaded. Various estimates have been made by official and non-official publicists, which vary from Rs. 200 to Rs. 800 crores of tax money due but not being paid into the Exchequer in the last 3 or 5 years. If that amount were to be rigorously collected, the difficulties of to-day arising out of unchecked Inflation would be easily solved. If the public conscience is aroused and educated to the pitch which may well be expected now that this country has a Government elected by the representatives of its people, there can be no doubt that this source will furnish the largest single item of revenue for the Centre and Provinces, while the basis of the Social Order remains rooted in Private property. The tax, moreover, has shown a degree of elasticity and productiveness which makes it ideal from the point of economics; while being adjusted as nearly as may be to the ability to bear the burden, it is unobjectionable from the ethical standpoint also

Shift in Emphasis.

Growth of Indirect Taxation.

It is clear, however, from an analysis of the Tax Receipts of to-day,—that emphasis has definitely shifted from Indirect to Direct Taxation in the Indian system of Public Finance, both at the Centre and in the Units. At the beginning of the century, for instance, Customs Revenue (wholly Central) and Excise (which is largely Provincial) were illustrations of

Indirect Taxation. Between them, they used to yield comparatively little, though in those years Income-tax Receipts were also not very considerable. Land Revenue was the principal form of Direct Taxation, which made the income from that category of taxation preponderant.

If we add, however, on the side of Indirect Taxation the income from Salt, Opium and other similar sources, the total from that category would appear to be greater at the turn of the century. Opium revenue was, perhaps, the most important single item of revenue, after land revenue; and was the more unobjectionable as it was derived largely from Non-Indian consumers in China and Malaya. Opium revenue came from a Government Monopoly, where the price was charged so to say up to the maximum the consumer could pay; and, as such, was not felt as a burden in this country at all. For these reasons it was in marked contrast with Salt Revenue which fell exclusively upon the people irrespective of their ability to bear the burden or was rather in inverse proportion to their taxable capacity. That source has disappeared from the Indian Budget since 1910, leaving a big hiatus that has not yet been filled up. No comparable economies are possible; no sufficient alternative or substitute available; Opium Revenue was dispensed with at the instance of the British Government, where the Non-Conformist conscience was roused and found in the export of Opium from India such an instance of nefarious traffic that they could not regard the Indian Government to be guided by Christian principles of international justice. By a Treaty with China, which undertook to abolish Poppy Cultivation at home within a stipulated period, India was made to reduce progressively her exports of Opium, by an increase in prices as well as by reducing her Poppy Cultivation. By the beginning of World War I. Opium had ceased to play an important part in the Indian Budget. The amount now shown under that head is from the consumption of Opium and other such drugs in the country itself. It is more an Excise Duty than a monopoly profit.

In the early years of the direct British rule in India, Customs Revenue could not grow at all in proportion to the Trade of the country, as the basic policy of Government in those days was not to place any barriers in the way of free flow of trade between countries. The Free Trade policy of the British Govt. was copied by their agents, the then Government of India, where it was wholly misunderstood, because the chances of local industry rising to its just stature were believed to be needlessly prejudiced so long as Government offered no fiscal protection to their establishment and expansion. Under the stress of World War I, however, when reve-

TABLE V

Analysis for Tax Revenue

(In crores of Rupees)

Year.	Revenue from Customs.	Revenue from Central Excise Duties.	Revenue from Taxes on Income including Corporation Tax.	Revenue from Salt.	Other Tax Revenue	Total gross tax revenue.	Tax revenue retained by Central Govt.	Total Cost of Collection.	Total net Tax Revenue.
1933-34	47,16		17,13	8.86	90	744.05	72.97	3.31	69,66
1934-35	52,67		17,55	8,00	1.05	79,27	78.08	3.51	74.57
1935-36	52,25		17.07	8.43	89	78,64	77,35	3,64	73.71
1936-37	51,45		15,34	8,81	82	76.42	74,96	3,77	71,19
1937-38	43,11	7.66	14,58	8,39	81	74.55	73,14	3.29	69,85
1938-39	40,51	8,66	15,78	8.12	83	73,90	72.34	3,75	68.59
1939-40	45.88	6,52	16,58	10.86	83	80.67	79.06	3.40	75.66
1940-41	37.30	9,49	21,77	7,67	91	77.14	75.50	3,34	72.16
1941-42	37.89	13.15	36,67	9.20	1.01	97.92	95.87	3.98	91,89
1942-43	25,12	12,79	74,86	10,91	1.21	1,24,89	1.23.61	4.47	1,19,14
1943-44	26.57	24.94	1.09,64	8,34	1.66	1,71,15	1,70,23	5.15	1,65,08
1944-45	39.76	38.14	1.64,68	9.29	1,96	2.53,83	2,52,81	7.05	2.45.76
1945-46 (revised)	65,00	46,65	1,60,25	9,25	2.12	2,83,27	2,82,67	8,04	2,74,63
1946-47 (budget)	65,55	46,70	1,16,86	9,30	2.14	2,40,55	2,39,13	8,11	2,31,02

Source:—Explanatory Memorandum on the Budget of the Governor-General in Council for 1946-47.

nue considerations became all the more insistent; and when it was felt Customs could be made to contribute much more than it did at the time, new revenue duties were imposed. At the same time a pledge was given for a revision of the governing policy as soon as the War ended. This new orientation in policy was embodied in the appointment of the Indian Fiscal Commission in 1921, whose majority recommendations were accepted by Government, and the policy of "discriminating protection" adopted for selected Industries after satisfying themselves through proper investigation by a Tariff Board that the industry asking for protection had a fair case for protection.

The immediate effect of a change in Fiscal Policy was to increase Customs Revenue through high duties on competing materials imported from abroad. And even where there was no room for competition, Customs Duties were raised several times in the twenties and thirties, so as to make an effective counterpoise to the income from Direct Taxation on income. These Indirect Taxes are favoured by all Governments, and particularly in Federations, as the tax-payer of these revenues is not conscious of the charge made upon him. If Democracy would like to be real and effective, it must prefer Direct Taxation, as then only will the citizen become fully conscious of the burdens of modern government, and exercise his vote, the symbol of his sovereign authority more intelligently than is commonly the case.

At the present time purely revenue or protective duties are levied and the aggregate net amount is over Rs. 84 crores as shown in the table appended.

TABLE VI

Budget of 1948-49: Customs Duties and Central Excises
(Figures are in lakhs of rupees)

I. CUSTOMS DUTIES	
(A) Import Duties (Sea Customs)	
(a) For Revenue	5412.00
(b) For Protection	688.40
(B) Export Duties	2252.55
(C) Land Customs	40.00
(D) Miscellaneous	75.00
Total	8468.00
II. CENTRAL EXCISES	3400.00
Grand Total	11868.00

While the most considerable instance of Indirect Taxation was revenue from Customs Duties, expanding local Industry developed by means of fiscal protection or because, of some inherent advantage of its own within the country, were also brought within the purview of Taxation. In proportion as they succeeded they paid more by way of Income Tax, Railway freight and fares, and excise duties on consumables obtained in the country itself. In addition, what are called some Excise Duties were also levied on the raw material or finished product of these industries, the yield at the present time from all of which is given in the Table VI given above.

Between them these two principal items of Indirect taxation were estimated to yield Rs. 115 crores, in 1948-49, as against Rs. 130 crores in round terms estimated to be derived from all kinds of direct taxes including, Income Tax, Corporation Tax, Excess Profits Tax etc. Indirect Taxation of this kind also displays an elasticity and productivity which are fairly comparable to the Direct Taxes noticed above.

Excise Revenue also forms a considerable part of the Provincial Purse. But there Excise Duties are levied on articles of consumption which the public opinion regards as injurious to the health or morals of the community. Attempts are accordingly being made to abolish such nefarious traffic, and sacrifice the revenue derived therefrom. Plans for Prohibition calculated to abolish the drink evil altogether within a given period, have been accepted in principle by the Provincial Governments, wherever they were under Congress influence, ever since 1937. With the return to office of the same Party in 1946, these projects have been revived in several Provinces. The experience of the earlier experiment had, however, made many Authorities realise the unwisdom of impulsive adoption and immediate execution of a Total Prohibition Policy. The present schemes, therefore, are aimed at progressive reduction of the evil and the income derived from it, by choosing particular districts in which the policy is being put into force, so that the desired goal may be reached in five years or so.

In proportion as this policy is realised, a considerable sacrifice of revenue would have to be incurred. The deficit, therefore, even now noticeable in the Provincial Budgets will tend to increase, and will have to be made good by devising alternative measures, or increasing the rates of taxation in the existing revenue, or enhancing subsidies or grants from the Centre which may be undesirable for constitutional or political reasons. In any case the Indirect Taxation described is impossible to be dispensed with, and be replaced by Direct

Taxation unless the present day heavy evasion is checked, and the tax-payer educated to the proper pitch of his duty to the State.

It may be added that, according to the Budget of 1946-47, the total gross Tax Revenues of the Government of India amounted to Rs. 240.55 crores, the cost of collection of the taxes amounted to Rs. 8.11 crores, or some 3% of the total tax receipts. The collection charges for Indirect Taxes of Customs and Excise aggregate nearly 10% of the gross receipts, i.e. Rs. 4.46 crores for a total gross income of Rs. 46.70 crores. The corresponding cost of Direct Taxes is a little over 1%, i.e. Rs. 1.31 crores on a total income of Rs. 1,11,16.86. The cost of collecting salt revenue was nearly 16% of minor taxes, the cost was proportionately very much higher, but in the aggregate it made little difference.

Between 1937-38 and 1946-47, the Customs rose from 43.11 crores to 65.55 crores, or a little over 50%; Central Excises rose from 7.66 crores to 46.70 crores or 600%; Taxes on Income, including Corporation Tax, rose from Rs. 14.58 crores to Rs. 116.86 crores, or 800%. This shows the shift during the War years, and the change is even greater if we take our starting point for comparison at 1930-31. The figures given above all relate to the Budget of 1946-47, as shown in Annexures I and II of the Explanatory Memorandum, pp. 22-23.

Other Sources of Revenue

According to the last Budget for united India, i.e. for 1946-47, the Net Revenue from the Commercial Departments, principally Railways and the Postal Services,—was Rs. 17.12 crores, or about 5½% of the total net revenue for that year of Rs. 299.27 crores. There have been considerable vicissitudes in this item, which yielded only Rs. 1.47 crores in 1938-39, net revenue and formed less than 2% of the total net revenue, of that year, i.e. Rs. 78.49 crores. During the War, this item rose sharply, from the lowest yield shown above to Rs. 46.61 crores in 1943-44, or nearly one-fifth of the total net revenues for that year. Since the end of the War, the yield has fallen rapidly, till it has fallen in the latest Budget for undivided India at 5½% of the total.

As has been pointed out in another volume in this Series, that on Communications and Transport, these Departments are capable of considerable expansion, and even of a substantial net increase in revenue, if only the Services are properly co-ordinated, and the country's goods and passenger traffic, as well as the various types of communications through the postal

Services are reorganised. The present policy aims at killing the goose that lays the golden egg by adding to the rates and charges of these popular services which are the monopoly of Government, but which have infinite possibility for development, if only the Services are made an integral part of the Overall Plan, and operated as an inseparable adjunct of the National Economy.

Currency and Mint

The Currency and Mint receipts record another heavy rise, from Rs. 22 lakhs in 1938-39 to Rs. 15.18 crores in the Budget for 1946-47. This reflects a heavy increase in the currency Note Issue, and consequent increase in the interest bearing securities in the Reserve, which, however creates its own difficulties through Inflation in Prices. That subject is examined in another volume in this Series.

VI. Provincial Revenues.

The most important items in the Provincial Budget are: Land Revenue, Excise, Forests, Stamps, Entertainments Duty, Sales Tax, Administrative Departments or Service Fees, Irrigation, Interest Receipts, Grants or Subventions, and Miscellaneous adjustments.

Land Revenue and Excise have already been discussed, and so need not take up any further space once again. The Excise Revenue is threatened with extinction, but no effective or adequate substitute seems to have been found so far. It may be that the share of the Provincial revenues in the now projected Estate or Death Duties which will very likely have to be shared between the Union and the units, may compensate the Provincial Purse for the loss of the Excise Revenue. The question is not judged as a financial problem only. Large issues of national policy or social Reform are involved, which cannot be decided in this Series, but which the National Planning Authority will have to settle before the Plan can be put into execution.

On the other hand, the abolition of the Zamindari or Landlord rights in land in Provinces where the Permanent Land Revenue Settlement was in vogue or where proprietory rights to large land-owners have developed even without Land Revenue being fixed there in perpetuity, is expected to bring in a considerable increase in the revenue from that source, from the State putting itself in the shoes of the Zamindar. A close study, however, of the Land Revenue System in those

as well as Ryotwari Provinces makes it unlikely that any considerable increase in revenue from this source should take place by the mere fact of the Zamindar being excluded from the ownership of land. In most Provinces where the Zamindari System prevailed recent Legislation for its abolition has accepted the principle of compensation to the Zamindar on a fair scale. This involves very heavy borrowing by the Provincial Governments abolishing the Zamindar. They must consequently shoulder a substantial burden of Interest on the borrowed capital as well as the Sinking fund charges for repaying the loan within the stipulated period.

In addition the rights of the tenants would also have to be reconsidered and given effect to in a liberal spirit. This means that the State becoming a Land-owner would not be able to demand and obtain Rent from land at the same rate or in the same manner as a land-owner used to do notwithstanding a long series of landlord and tenant legislation. Take an instance. In the United Provinces the final Revenue Settlement was made somewhere about the middle of the last century. Under it the total Land Revenue in the Budget for 1946-47 was Rs. 6.68 crores. The Zamindars' or Talukdars' income from their land was estimated at three times as much; so that the gross income from land would be about Rs. 20 crores. Recent estimates show that to expropriate Talukdars or Zamindars the United Provinces subject to a fair compensation would necessitate borrowing to the tune of Rs. 137 crores, which, at 3½% interest, and sinking fund charges combined, would mean a net charge at least of Rs. 4 crores on the United Provinces Public Purse. If the entire Zamindar income is taken over by the State in this instance, Government would be gaining, at existing rates, Rs. 20 crores minus Rs. 4 crores on account of interest and sinking fund charges in connection with the loan raised to pay off the land-owners, Out of the Rs. 16 crores that may remain, the State would have to remit a considerable portion of the Rent charge made by the expropriated Zamindar, to make the land held by the actual tenant yield sufficient and a fair return or a living wage to the actual cultivator. No charge could be made until a minimum necessary for the cultivator's maintenance has been deducted, and the Land Revenue placed on a par with the direct tax on income. Exactly what sacrifice of revenue would be involved by this approximation of the tax on Land to the other great direct tax on income is impossible to say. Given the phenomenon of intense subdivision of cultivated land prevailing in all parts of the country, it is more than likely that the exemption of a minimum necessary for subsistence from land, would absorb

a very large slice of the net revenue from land after the abolition of the Zamindari or the Talukdari System. The present figure of about Rs. 6 2/3 crores of Land Revenue will not be very much increased by this reform of the financial system, so long as private property in land is allowed to the cultivator. The reform would also have to be accompanied by a complicated series of social legislation ensuring no further subdivision of land and enforcing economic cultivation, without which the initial step will prove barren and meaningless. The Co-operative Reorganisation of the entire Agrarian System, recommended in another volume of this Series, may, if adopted, involve further deduction from the Provincial Purse. But that would be no loss to the country as a whole, if we look at the benefit derived by the members of the Agricultural Co-operatives.

After the abolition of the Zamindar or large landowner any hope of a substantial addition to the Provincial Purse by means of an Agricultural Income Tax must also shrink in proportion as the taxable surplus of income from land would be very much reduced, and the amount possible to derive from that source may be much smaller.

If the entire programme, including all items of rehabilitating the agriculturist in India by removing the burden of unproductive Debt, parasitical Rent charge, excessive land revenue demand by increasing the size and improving the method of cultivation, and by co-operative reorganisation of the entire system of land tenure and cultivation, it may be very likely that this source would yield much more in the aggregate over a series of years than has been the case under the system of fixed cash land revenue paid to the State or rent dues of the Zamindar. But until the entire Plan in all its items is carried out, reforms effected bit by bit may prove more onerous than advantageous.

In recent times, that is to say, since the Government of India Act 1935 and the arrangement for redistributing financial resources following the Otto Niemeyer Award, the Provincial Purse has been progressively benefiting by a share in the ordinary income tax levied and collected by the Central Government. The principle has been accepted that the Provincial Governments are entitled to share in this tax upon the wealth of the citizens within their jurisdiction, if not wholly, at least in part. By this arrangement 50% of such revenue is made available to the Provinces, and the Provincial Purse has been proportionately benefiting from this source.

In recent times this source has been considerably expanded by the Central Government for its own reasons, and it is likely to be still further expanded in the years to come. With the progress of Industry and Development of all other resources of the country, which a Plan like the one outlined in this Series is likely to bring about, it may very likely be that the Provincial share of the revenue derived from this source would more than suffice to make up any loss that may occur in the abandoning of the Excise duties on intoxicants, and the reconditioning of the Land Revenue as part of the reorganisation of the entire Agrarian Economy, on a par with the Tax on Incomes. But here, too, emphasis must be laid on the fact that these are mutually interdependent devices for attaining the common objective of all-round national development and that can best be attained by an integrated National Plan taking account of all items, aspects of our National Economy including the Financial side.

After Land Revenue, Excise and a share of the Income Tax, the other items of Provincial Revenue are relatively less important. Forests yield a varying income in the different Provinces. But they are capable of much greater expansion than was realised by the preceding Government. As pointed out in another volume in this Series, that on Soil Conservation and Afforestation, the potentiality of Forests as a source of provincial revenue, as well as of adding to the national wealth is unlimited. Forests, it need hardly be added, are a part of the Public Domain, the present income from which bears no proportion to its possibility. The development of sylviculture and of the industries based on Forest produce, owned and managed directly by the State, are calculated to yield far more net income than the present 5% to 10% of the total Provincial Purse from this source, even though at the outset this part of the Plan may require considerable capital investment.

Stamps are a more important source of Provincial Revenue from the point of view of the total yield. They are a form of Indirect Taxation, falling upon the commercial class mainly—or litigants,—which may be deemed as apportioned to the capacity of the tax-payer to bear the burden, and as such innocuous and unobjectionable.

Large-scale Irrigation Works in many Provinces yield considerable net revenue and still show still further scope for expansion. Great projects of Multi-Purpose River-Training and Irrigation Schemes, including generation of Electrical Energy, resettlement of land reorganisation of cultivation, establishment of new industries, have been taken in hand by

the Central Government in the last year, as mentioned in the volume in the series dealing with River Training and Irrigation. This is a very promising source for adding to the Provincial Purse, and has a great future if properly linked with the other items and aspects of reorganising Agrarian Economy mentioned above.

As against this scope for developing Productive Works, there is, however, in many Provinces an equal if not greater need for Protective Works to guard against the particular regions against failure of rains, and consequent famines rather than for additing to the revenue of the State. There are many Provinces in which this danger is a common risk, so that in such parts of the country the net revenue from this source, taking both Productive and Protective Works together, may not be very considerable. Amounts spent, moreover, whether by loan to cultivators or directly by the Provincial Exchequer on smaller works like wells or local ponds, may add to the wealth and taxable capacity of the cultivator, but not much directly to the net revenue of Government. For the country as a whole, however, it is possible to make this source yield, in the aggregate, within not more than ten years, a much larger amount than is derived today. All these measures one cannot repeat too often are so closely inter-connected and inter-dependent that they will have to be adopted as part of a National Plan, and given effect to simultaneously if the fullest benefit is to be obtained.

Fees from Service or Administrative Departments, like Education, Police, Medical and Health, Agriculture, Industries, etc. do not form a very considerable proportion of the Provincial income today. But they are objectionable on principle, in so far as those are essential Social Services without which no State can be regarded as civilised. No Fees should be charged at least in the elementary stage of what is called Primary Education, and a pre-determined minimum of attention to the health of the community, as well as to its livestock wealth. This country has so long lagged behind in such matters,—its literacy proportion is the lowest in the world, its expectation of life the shortest, its agricultural productivity the poorest—it must now make up the lee-way at as early a date as possible. Progress, however, in all these elementary services would be very much impeded so long as the burden in the shape of Fees for such enterprises and elementary services are retained. The new Governments will have, therefore, at once to shoulder, not only the burden of substantial and immediate expansion in these services, but also to remit the Fees now

derived from some of these sources, some observations will be offered on the Expenditure side in this regard. Here it is enough to add that revenue or financial considerations should not be allowed to affect progress in these Departments which is very much overdue.

Interest and Miscellaneous Receipts are more than counter-balanced by corresponding charges on the other side. The interest Receipts of the Government of India are derived mostly from Loans to Provinces and States; while those of the Provinces are obtained from Loans to Municipalities, District Boards and the like. These, however, are more or less counter-balanced by the Expenditure under the same head on the other side, and so need not occupy us more in this place.

Miscellaneous adjustments between the Units and the Centre, in the shape of specific grants or subventions from the latter to the former are growing ever since the National Government has come to power. They will continue to grow in all likelihood, if the new Constitution concentrates power and authority and resources mostly at the Centre. The questions involved in this subject, are therefore, more constitutional and political than purely economic or financial. It stands to reason, however, that the resources of every Unit may not be adequate to the planned and progressive development of a given unit, and making it comparable, in point of administrative efficiency, social service and public utility with any other member of the Union, or with other countries in the world. The Central Exchequer must, therefore, come to the support of not only backward Units like the States, which have only recently been merged in the Union, to bring their administrative efficiency and social services to a comparable standard all over the country but also to the larger and better endowed Provinces who have lagged behind, not withstanding their inherent resources for want of planned enterprise to march forward in social reform and industrial development.

The introduction of special subventions or specific grants from the Centre may lead to a degree of restriction or limitation of Provincial Autonomy, in the shape of conditions imposed for utilising the grants or subventions made. These also involve constitutional and political questions, with which this volume need not be burdened. It is part of the main Committee's task, or the function of the Supreme Government in the Country to resolve such questions and devise a general policy for all.

Recent additions or innovations in the Provincial revenue system include Entertainment Tax on all kinds of amusements, like cinemas, concerts, theatres, and other

forms of public entertainment, or other less desirable activities like Racing and Gambling; and Sales Tax. Considerations of social and economic importance are involved in these forms of local taxation, which, however necessary for financial reasons, should not be the prejudice of basic social ideals or ethical principles. In a Province like Bombay, taxation of this kind is likely to be very productive if rigorously enforced. If all forms of gambling, for instance, speculation as well as racing or gambling proper, are duly brought to the Tax Collector's attention, the revenue from such items would be considerable. They may be supplemented by organised State lotteries, or special License Fees on stock brokers or on organised exchanges where forward dealings are common. But they may all be open to objection from the moralist who objects to any kind or degree of State association or countenance with these anti-social activities.

Taxation, moreover, on healthy recreation or entertainments may affect the public welfare by making the educational or cultural benefit from such activities, e.g., the Theatre or Cinema beyond the people's means, so that those who need such recreation or entertainment the most may be unable to afford it. These entertainments are, no doubt, liable to abuse. But to guard against that institutions like the Film Censor Board may be established. A balance between advantage and evil, which is inextricably involved in all such matters, will have to be struck, so that a just mean may be attained in the interests as much of the Public Purse as of the social well-being of the people.

A Tax on Sales on the other hand, stands on a different footing. It is an indirect burden borne by the consumer which is scarcely noticed, since the tax is included in the price. There is no doubt of considerable yield being available, if this Tax is imposed on sales of selected commodities all over the country subject to an exemption of very small amounts, at uniform rates and by the same machinery. The danger, however, in the Sales Tax being levied at different rates on different commodities in different Provinces is so considerable, that its centralisation for purposes of administrative uniformity and efficiency becomes unavoidable. The proceeds of the centrally levied tax may then be shared, as the Income Tax proceeds are shared today, by the Centre as well as the Provinces on some agreed lines. With a tax of a uniform basis on identical commodities with identical exemptions, no room would be left between rivalries as between Units for attracting trade or industry to their own borders, the same remark

may also apply to devices such as Licensing Duties for shops or particular scale industries, and other activities resulting in an increase in production or improvement in consumption. In so far, however, as those burdens fall unevenly on people's different ablilities, it would be undesirable to impose them.

VII. Public Expenditure

A (Central)

Given the orthodox view of the functions of the State in India as accepted during the British regime, and taking the role of Public Finance to be what has been outlined in the preceding pages, Public Expenditure also follows the same ideal of the **faineant** Government. There is no trace of a planned utilisation of Public Expenditure for either effecting an overdue re-distribution of the National Wealth, or so ordering the outlay of the State as would directly promote the well being of the citizen. Public Expenditure of both the Central and Provincial Governments is thus content to keep order, enforce peace within the country, and ensure its security against outside aggression.

Table I in this Introduction gives the total of such Expenditure, both Provincial and Central. A sharp and heavy increase has occurred in the last 10 years in either case. Notwithstanding this remarkable increase in the total expenditure, the ideal of the State sketched elsewhere remains the same, as is evident from the Table below which gives the broad details of Central Expenditure.

Before considering the several items in this Table in detail, we may notice some of the more salient characteristics of Public Expenditure in India. The total Expenditure is made up of the Central Government Expenditure, and that of the Provincial Governments, of the States and of Local Self-governing bodies, Statutory Authorities or Corporations; and of the Indian States. Reliable figures are available only for the first two categories. A few of the Indian States also publish their Budgets; while the Local bodies and Statutory Corporations are too heterogeneous to permit a consolidated view. Until August 1947, moreover, the Indian States were not integral parts of the same polity; but they followed, essentially speaking, the same pattern.

If we view the aggregate Expenditure historically, the most outstanding peculiarity would appear to be an incessant and uncontrollable tendency to increase. This is not peculiar to India; but in recent years the increase has been very steep and rapid. Much of this increase in the last decade was due

TABLE VII

Distribution of Expenditure (In crores of Rupees)

Year.	Interest on Debt.	Reduction or Avoidance of Debt.	Extra-ordinary Payments.	Defence Expenditure (net)	Other Expenditure.	Net capital outlay of commcl. depts. (Posts & Telegraphs and Irrigation) met from revenue.	Total net Expenditure.
1933-34	9,29	3,00 (b)	2,19	44.42	15,85	6	74,80
1934-35	10,25	3,00 (c)	2,85	44.34	19.92	3	80,39
1935-36	10,50	3.00 (d)	2,72	44,98	17,08	1	78,39
1936-37	9,56	3.00	19	45,45	19,26	4	77,50
1937-38	12,48	2.52	3	47,35	28,77	4	81,19
1938-39	11.12	3,00	1	46.18	18,78	4	79,13
1939-40	9,00	3,00 (e)	7,95	49.54	19,34	—	88.83
1940-41	9,78	3,00	1,22	73.61	20,28	1	1,07,90
1941-42	6.40	3,00	4.65	1.03.93	21,68	1	1,39,67
1942-43	6,97	3,00	30,26	2,14,62	25,94	3	2,80.82
1943-44	9,09	3,00	30.66	3,58,40	29.47	—1	4,30,61
1944-45	19,21	3,00	31,03	3.95,49	36,61	4	4,85,38
1945-46 (revised)	30,85	3,00	22,26	3,76,42	61,10	2	4,93,65
1946-47 (budget)	36,97	5,00	7,20	2,43,77	50.38	1	3.43,33

(b) Includes 2,09 transferred to the Bihar Earthquake Fund.
(c) Includes 2,82 transferred to the Rural Development Fund.
(d) Comprises 1,84 transferred to the Revenue Reserve Fund, 45 for buildings in Orissa and Sind, and 43 for expenditure in connection with the Quetta earthquake.
(e) Includes 7,77 transferred to the Revenue Reserve Fund.
Source:—Explanatory Memorandum on the Budget of the Governor-General in Council for 1946-47.

to the steadily rising War demands during 1939-1945. To meet this insatiate demand revenues had to be steeped up from every source that could possibly be made to yield more by raising the rates of existing sources, or by devising new forms of Taxation or other forms of Revenue. The growth, it may also be noted, is to be found both in the Provincial and Central Budgets; but the latter far out-weighs the improvement in the former. It is unnecessary to go into the details of the finances of the several Provinces.

It may be mentioned, however, that not all Provinces fared equally during the War for a variety of reasons, like the Bengal Famine 1942-43, or the War scare about the same time there, or the political agitation in the country, and the like. It is enough, for our purposes, to record that Revenues have grown notwithstanding new taxes and higher rates disproportionately with expenditure all over the country; and that the resources of the Central Government have shown a much larger tendency to grow than in the case of the Units, very likely because the latter have very few elastic sources of income at their disposal, while the demands of daily governance and social reform facing them are steadily and sharply expanding.

(a) Characteristics of Central Expenditure.

Taking Central Expenditure by itself, a large proportion of it is non-productive. Nearly half, if not more of the Budget is devoted to Defence and preparation for Defence, even in normal peace-time, while during the War it was still further inflated. Indian public opinion had, in the British regime, been always sharply critical of the Defence or Military Expenditure, as being part of the Imperialist exploitation. Undoubtedly this burden was mainly imposed because of our connection with Britain. In peace we had to be prepared for Wars, British Imperialism brought upon us; in wars we had to join whether or not we desired them or benefited from them. The size of the Defence Budget, continues even after the British connection has ceased. World War II, which brought about a sharp increase in this Expenditure has ended these three years and more; and though the item has in its aggregate been brought down from the peak of war-time Defence expenditure, its general character, proportion and policy remain unchanged. Apart from the Defence Budget proper, if we take into account the item of Interest on the Expenditure side, the proportion of the Public Purse claimed by the Defence Budget would be even greater. The Public Debt of India has in its inception and subsequently been

caused, very largely, by the wasteful expenditure by the East India Company from which the British Government took over governance of the country; and by the Wars, Expeditions and insatiate Imperialism of the British Government of India during the 90 years that it held sway in this country.

Accordingly it would be right and proper to include some proportion at least if not the whole, of the Interest Expenditure as part of the Defence Budget.

(b) Unproductive Items of Expenditure—Defence.

The Defence Budget is unproductive in the sense of giving no return in the shape of material goods. The sense of security, however, that is born of adequate provision for Defence against aggression cannot be valued in terms of money. It is a condition precedent to any normal functioning of the economic machine; and as such it cannot be termed wholly as unproductive in every sense of the term. In the existing circumstances, however, of international relations with the impending threat of War all over the world, it would be suicidal for any country to neglect or reduce its provision for maintaining its own security, integrity and independence. This provision, therefore, has to be on a scale proportionate to the area and population, the coast line, and trade that this country has with other countries of the world.

It is this consideration of National safety which even suggests a possibility of early and substantial expansion even in the present high figure for Defence, large as it is. For her extent and population, India has a relatively small standing Army, with little or no reserves. As for a comparable Navy and Air Force, the first beginnings have yet to be made. These are, however, necessarily expensive to provide all the more as there is an inexorable and incessant tendency in modern weapons and equipment to become obsolete very soon after their production. The constant rivalry, moreover, that goes on among the leading nations of the world makes it impossible for any country, anxious to preserve its independence and maintain its own way of life, to be content with outworn, inefficient, obsolete armament. New weapons, new modes of fighting, new strategy have a tendency to make the arms and equipment of today, however efficient and up-to-date it may be, useless tomorrow in the face of new discoveries and developments. This Expenditure must, therefore, be porportionately much larger not only from the point of view of any return but also from the point of view of its continuous increase for the reason just mentioned. India would nevertheless have to maintain the present level, and even

increase it, if she desires to maintain her Independence and individuality in the world to-day. Notwithstanding the philosophy of Non-Violence preached all his life by Mahatma Gandhi, the country he brought independence to cannot survive as a nation if it discarded its defence provision and eschewed altogether the use of force. Within less than a year of his death, his leading Lieutenants and chief Disciples are obliged, publicly, to profess, if not a new faith, at least a new policy to ensure the Defence of the country more in conformity with the conditions of the world than the teachings of the Founder of India's National Independence.

It may be noted also that however large Expenditure on Defence may seem to be in proportion to the total Income of the State in India, many of the peculiarities of the pre-independence Budget that made it open to criticism have ceased to operate since the establishment of Independence. A good deal of the Defence Expenditure during the British Regime was in the shape of the so-called War Office Charges, which constituted a net **drain** from the country. The overwhelming majority, again, of the Officers in the Defence Services were Non-Indian, whose salaries and pensions may likewise be said to have been a net **drain** out of the country. The monies spent on these accounts were a net loss to India. The weapons and armaments and equipment, which had to conform to British needs and Standards, had also to be obtained from British sources. In a manner of speaking they, too, constituted a drain of wealth from this country. Only a fraction of the total expenditure on Defence remained in the country in the shape of the soldier's wages; the bulk unavoidably appeared to be an unrelieved burden.

Under the new dispensation, however, much of this has been changed. The War Office Charges have ceased to be as the Indian Army is almost entirely Indianised. The salaries, pensions and leave allowances of British Officers in the Indian Army have also disappeared from the Budget; so that two of the biggest items of the Drain may well be said to have come to an end. All arms, weapons and equipment have yet, no doubt, to be procured from abroad, whether from Britain or any other country more advanced in such production. In proportion as the size and equipment of the Armed Forces on Land or Sea or Air increase, the need to procure all such material will also increase, and so also their cost. The bulk of the Indian Armed Forces being nationalised, the item of their pay and the allowance and expenditure on their clothing, food, or housing, remains in the country. It is no more than so much re-distribution of the country's wealth.

Until, however, the country develops her own Armament Industries, and produces all the manifold and complex requirements of modern armed defence within her own borders, the most serious item of the old time Drain will remain. We need, not only the Industries directly concerned with production of arms and warlike equipment of all kinds, that would stop this drain, but we must have all the ancillary and connected industries without which the coping stone, so to say, of the industrial structure will not be laid. Wholesale industrialisation of the country on a modern level is indispensable, as without it the War Industries proper cannot function. The volume and variety of such industries will have to be in proportion to the size of our army, navy, air force and their respective reserves. The Armed Forces of the country will need to be very much expanded, and reserves as well as auxiliary Services of all kinds raised in proportion if the defence of the country is to be amply assured. If the real burden, therefore, of the Defence expenditure is to be reduced, it can only be when the entire volume of such outlay, however large the figure, is merely a redistribution of the total wealth of the country whether in the shape of salaries or wages of the personnel, their pensions and other allowance, or in the shape of stores and materials, armament and equipment, needed for maintaining the Armed Forces of the country at the highest level of efficiency.

(c) Home Charges.

Another similar characteristic of the Public Expenditure under the British Regime was the so-called "Home Charges". In their aggregate, they constituted a serious drain. Part of this was due to the War Office Charges already mentioned, and part to the civilian items of pensions, leave and other allowances, Government Stores, Interest on Sterling Debt, and cost of the India Office. Most of these have now come to an end, or will soon do so. While they lasted, the "Home Charges" aggregated Rs. 40 crores per annum or more in the period between the two World Wars; and before World War I they totalled Rs. 20 to Rs. 25 crores. The disappearance of these charges does not mean a substantial relief to the Indian Exchequer. As many of the items coming in this category will remain a charge, though the money spent will remain in the country.

The disappearance of the Home Charges, or weakening of this Drain will also affect India's Balance of Trade and of Accounts. The surplus of exports over imports which India had to maintain to pay these charges need no longer be provided. This aspect of the question has been more specifically

considered in the Volume in this Series dealing with Trade, and another with Currency and Banking, so that no more space need be wasted on it in this Volume. Note must be taken, however, of the continued need of India to-day to continue heavy Imports from abroad on account of Food and Capital Goods for building up new Industries, which for the time being make the usually favourable Balance of Trade adverse to India. Even the final Balance of Accounts of the last few years, after making full allowance for all debits and credits is adverse, because of the impossibility to realise our accumulated Sterling Balances, or any substantial portion thereof, so as to meet the adverse balance against India for the time being.

Of the other items that made up the Home Charges, Interest on Sterling Debt was the most considerable. Much of the Sterling Debt has, no doubt, been repatriated and converted into Rupee Debt during the War, as a result of the accumulation of large credits due to India for goods and services supplied to Britain in her hour of need. The Debt has only been converted into a corresponding Rupee Debt, and, therefore, the burden on the public purse has not lessened. The repatriation of the Sterling Debt was acclaimed by the supporters of the then Government as an act of great economy and farsighted Statesmanship. They overlooked or ignored the fact that this amount, which carried interest at 3½% or 4% would, if made available for investment in productive industry in India, have earned 10%, or much more. From that point of view the transaction meant a loss rather than a gain to India. And as for the Statesmanship implied in this deal, we can only remember that by converting the Sterling Debt into Rupee Debt, India lost proportionately the bargaining power she might have had if the conversion had not taken place. For the rest, what is of material importance in this connection to note is the transformation of the nature of this burden from a net drain from the country into a redistribution of that part of the wealth which is accounted for by the so called Interest Charges.

Stores Purchases from abroad will, no doubt, continue until the growth of the necessary Industry in the country is sufficient to provide all the required stores and equipment from our own production. Even though this item was reckoned as part of the Drain it was not a net loss. Some value was received against this outlay. The Pensions charge of British Civilian and Military Officers retired from Indian Service has been capitalised under the Agreement to settle the Sterling Balances. That item will remain in the Indian Budget, but its burden will no longer be the net drain it used to be; and its incidence would be progressively reduced.

The unproductive characteristic of India's Expenditure is also explained by the Interest charge which accounts for Rs. 61.82 crores out of a total Budget of Rs. 257.38 crores in 1948-49. It is customary to represent a part of this Interest Charge as being set off against income from productive assets built up out of borrowed capital; and in this way Rs. 25.66 crores is deducted on account of Railways, Post Office, Irrigation etc. The only productive assets that may correctly be said to bear their own burden of interest are the large-scale Irrigation Works, whose financial aspect has been noticed more than once in several other Volumes in this Series. The capital outlay on Railways, Posts and Telegraphs and other means of Transport or Communications are also taken to be selfsupporting. But neither of these two great Departments of State has always shown a surplus of revenue over expenditure or earning capacity equal to the outlay thereon. In fact, if a proper account were taken of all the capital outlay and income from the Railways, or the Postal Services, it is doubtful if from 1857 to date there would really be left a net surplus on their account.

Even if it be granted for the sake of argument or convention, that these are earning assets, and as such the Debt incurred on their account may be regarded as productive, there is a large slice of that Debt which is frankly due to War Charges foisted on this country by its connection with Britain. The unsupported Debt of the Government of India costs, in the Budget for 1948-49 is Rs. 36.16 crores; and almost all of that is a legacy of British Imperialism which has no countervailing element. It must, therefore, be pronounced to be wholly unproductive*

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* Interest on debt and other obligations—Under the Indian Independence (Rights, Property and Liabilities) Order 1947, all liabilities in respect of such loans, guarantees and other financial obligations of the Governor General in Council outstanding immediately before the date of partition have been placed on the Dominion of India, subject to the recovery of an appropriate contribution from Pakistan. Provision has accordingly been made for the interest on all outstanding loans. In regard to the outstandings in respect of Post Office Savings Bank and Post Office Cash, Defence and National Savings Certificates it was agreed that each Dominion should take over liability for the deposits and certificates outstanding in its respective area subject to adjustments for transfers from one Dominion to another till the 31st March 1948. The provision made for interest on Savings Bank Deposits and for bonus on the certificates takes into account this decision of the Partition Council. Similarly it has been assumed that the balances in the Provident Funds of Government servants who opted for either dominion will be taken over by that dominion from the date of the partition. Similarly the provision for interest on Depreciation and other Reserve Funds and the recovery of interest on the capital

The item of Interest figures very substantially in both the Provincial and Central Budgets. It occurs also on the Income as well Expenditure side of the National as well as local Budget. Explanation has been given, while discussing Revenue in the earlier pages of this Introduction regarding the place of this item on the Revenue side. The Provincial Expenditure on the Receipt account may more justly be said to be self-supporting, as the bulk of Provincial Debt is in connection with building up productive assets, the income from which is much greater than the outlay on that account.

The component parts of the Public Debt and the analysis of the interest charge given below will give an idea of the proper place and importance of this item in the Public Purse of this country.

TABLE VIII

Interest on Rupee and Sterling Debt.
Budget 1948-49
(in lakhs of Rupees)

Gross Payments

A. — Interest on Ordinary Debt —		B. — Interest on unfunded Debt & Other Obligations —	
(i) Rupee Debt —		Bonus on Post Office Certificates	3,14.05
a) Management of debt	27.50	Post Office Savings Bank Deposits	2,40.30
b) Expenditure connected with the issue of new loans	5.70	State Provident Funds	3,05.77
c) Discount written off to revenue	60.15	Service Funds	17.26
d) Interest on temporary loans	44.50	Railway Depreciation Fund	2,74.15
e) Payment of prizes in respect of 5 year Interest-free Prize Bonds	10.00	Railway Reserve Fund	21.93
f) Interest on all other loans	43,97,77	Railway Betterment Fund	41.12
g) Other items	.30	Posts & Telegraphs Renewals Reserve Fund	16.67
		Other items	2,56.69
		Total	14,87.94
	45,45.92	Gross Payments	61,81,93

outlay of Commercial Departments allows for the reduction in the outstandings as a result of the partition. As mentioned earlier, a moratorium of 4 years has been given to Pakistan for the repayment of the partition debt and consequently no credit has been taken in these estimates for any recovery from Pakistan.

(ii) Sterling Debt—		C. — Transfers —	
		Deduct — Amount transferred to —	
a) Interest on loans contracted in England	19.44	Railways	22,52,81
b) Interest on Railway annuities	69.15	Irrigation	.95
c) Interest on outstanding liabilities of Railway companies taken over on purchase	.32	Posts & Telegraphs	96.84
d) Management of debt	.40	Commutation of Pensions	10.00
e) Other items	58.76	Other heads	9.03
		Provincial Governments	1,96.02
		Total Deductions	25,65.65
Grand Total	46,93.99	Net Interest Payments	36,16.28

In the Budget of 1948-49, the total interest bearing obligations were (India and England) Rs. 2,23,071.

(d) Grants and Subventions.

A large space is beginning to be occupied in the Central Budget on the Expenditure side by what are known as Grants to special Institutions or Funds and subventions to Provinces. These items of Expenditure are primarily charged on the Provincial Purse. In order however, to enable the latter to develop more rapidly and intensively their Social Services and nation-building departments like Education, Health, Agriculture or Industries; and, further, to bring all units into line in regard to the general policy as well as to co-ordinate similar effort simultaneously made in several parts of the country, the policy has in recent years been evolved and applied more and more intensively to provide substantial grants from the Central Exchequer to specified institutions like the Research Councils, Road Fund, and so on; or to Provincial Departments in the shape of subventions to promote or maintain given objectives.

According to the Explanatory Memorandum on the Budget of the Central Government for 1948-49 the total of Developmental Grants from the Revenue Budget is 10.77 crores. While that from the Capital Budget is 89.50 crores. The more important items in the former are:—

TABLE IX

Provision for Development Expenditure

(Important items)

A. Revenue Budget (in lakhs of rupees)

Meteorology — Development Schemes —	40.00
Grants-in-aid to the Engineering & Technological Institutions	25.00
Grants-in-aid to the Indian Institute of Science, Bangalore	59.70
Education — Non-recurring grant to the Delhi University	22.19
Aviation — Development Schemes	1,69.25
Broadcasting — Development Schemes	30.42
Civil Works — Maintenance of National Highways	2,50.00
Resettlement and Development. Resettlement Expenditure in connection with Medical College and Hospital for licentiates in Calcutta	23.89
Resettlement & Development	
Assistance to Aligarh and Benares Universities for establishment of Medical College	20.00
Grants to the Delhi Rural Health Organisation, construction of wings in the Irwin Hospital, etc.	36.80
Advanced studies abroad	29.21

and the important items in the Capital Budget are:—

B. Capital Budget

	(in lakhs of rupees)
Capital Outlay on Development	
Irrigation. Assam Valley Project	20.41
Civil Works — Buildings and Roads	2,08.12
Communications (National Highways)	6,23.29
Grants to Provinces	30,00.00
Capital Outlay on Industrial Development	
Fertiliser Factory	6,59.80
Industrial Finance Corporation	1,00.00
Capital Outlay on Civil Aviation	
Civil Aviation	4,08.84
Capital Outlay on Broadcasting	
Broadcasting	69.71
Interest-free and Interest-bearing Advances	
Loans to Provinces	32,00.00
Loans for Grow More Food Schemes	2,00.00
Loan to the Damodar Valley Corporation	2,00.00
Loans to major Port Trusts	1,40.00

The comparatively large grants or subventions on account of agriculture, education, health, scientific and minor departments in the Central Purse should normally come under Provincial Budgets only. They are at present very much increased, and will continue to be so for a considerable number of years to come, if the new spirit of active and intensive development of all available resources in all parts of the country continues to grow. This, it may be remarked in passing, is an important feature which must figure very prominently and extensively in an overall National Plan if and when one is prepared and put into force.

B. (Provincial)

The general characteristics of Provincial Finance follow the main lines sketched above with reference to the Central Finances. There has been a rapid and substantial growth in the aggregate Expenditure of all the Provinces in the last decade, as shown by Table VII given earlier. But the financial position of every Province during the last 10 or 11 years has not been one of equal progress and prosperity. Provinces like Bengal have had reverses from the effects of which they have yet not escaped. And the recent rise in prices and the consequent increase in the cost of administration has very materially reduced the favourable margin which Provinces like Bombay have shown during the War years.

Details of some Provincial Budgets for 1946-47 are given in the Table annexed. They will serve to show that the most important items of provincial expenditure are of course the Social Services and Public Utilities. In almost every one of these the previous regime had shown culpable indifference. A heavy lee-way has consequently come as a legacy to make up which very heavy expenditure must be undertaken in the coming years if the country is to be brought to a level worthy of a civilised community. It has been computed, for example, that in the Department of Public Education the aggregate of the present national outlay is some Rs. 35 crores, which provides a very limited instruction in the rudiments of education to some 15 million pupils. On a modest basis of a 15 years Plan, within which to bring basic education to every child in the Community of from 6 to 14 years of age, will cost in the 15th year some Rs. 350 crores; while even in the initial years of such a Plan the cost would be very much higher than to-day. The same applies to health and other social services.

Adequate and progressively expanding resources must, therefore be found to meet these unavoidable demands upon the Public Purse. Grants or Subventions from the Centre

would not only be inevitable; they would have to be much more considerable than to-day, besides substantial increases in the Provincial Resources. No curtailment or reduction of the programme now being prepared and given effect to in these Departments can be permitted, no matter how rigorous the urge for Retrenchment, and how insistent the need for economy.

These Departments, moreover, must be made integral part of the National Plan and their development and expansion must be made a **sine qua non** for the realisation of the entire Plan. Whatever restrictions and limitations have to be imposed on other items of consumption, these must be liberally treated, as their development would indirectly raise the standard of living of the people, which is a primary objective of the Plan.

This does not mean, indeed, that in reordering the Public Finances of the country, we must ignore all demands of economy. But there is a distinction between true economy, in the fullest and the best sense of the term, and mere Retrenchment, which is apt to confuse cause with effect, and apply the axe at the wrong root. The overall Plan, giving the fullest importance to these Social Services and Public Utilities, would, at the same time, recognise all the legitimate claims of real and lasting economy. It would sacrifice neither efficiency nor objective, and yet achieve the highest return for every rupee spent. Those in charge of the Financial Sector of the National Plan will, accordingly, have their task cut out for them, in trying to reconcile these seemingly incompatible demands of the programme for intensive development and the limit imposed by available resources.

VIII. Economy and Retrenchment.

A clear distinction must also be drawn between Expenditure on the Social Services proper, as well as the material, apparatus or equipment needed to make the Service the most efficient possible; and the purely administrative machinery required to provide, maintain and control these services. The cost of administration, including Police and Jails, Law and Justice, as well as the higher paraphernalia of Government, is proportionately very high in this country, thanks chiefly to the precedents and traditions of British Government in India. Compared to the wealth of the people, the public service in India particularly in the higher grades was the costliest in the world. The alien rulers of India conceived the opportunities for employment available to them in India in the various departments of the public service as so many means or avenues

of exploitation rather than as occasions for rendering a fair return for the employment and emoluments provided. They therefore, not only laid down extravagant scales of remuneration for a very mediocre type of work; but also invented or designed a number of occasions or excuses for additional allowances far beyond the ability of the country to support them, and out of all proportion to the service given. The new rulers of India, being native to the soil themselves, and fully realising the extravagant scales of remuneration for public service, will have to review fundamentally the scales of pay and emoluments allowed to administrative officials. Mahatma Gandhi's ideal of no post carrying more than Rs. 500 per month has been abandoned long since even by his foremost disciples. But even if that is impracticable or undesirable a limit, the top layers of income being a hundred or thousand times higher than the average per capita income, must be open to serious criticism. The Report of the Pay Commission (May 1947) was framed too near the Transfer of Power from the British to Indian hands; and under conditions of a steadily rising price-curve, to be a fair presentment of the wages of public service in correlation to the wealth of the country, or the average income of its citizen. A correct, scientific adjustment is necessary, a scientific approximation needed between the service rendered and the remuneration earned, and that in its turn must be in proportion to the standard of living of other classes of citizens not directly in the public service. If, as envisaged in this Series, the National Plan results in a progressive socialisation of all Services, Utilities and major Industries, the extent of Public Service would be far larger than is possible to conceive in a social system founded on private property, and the profit motive. The model of public employment would become universalised, and so the proportion between public salaries and private gains would be comparable. Other items of Public Expenditure would have similarly to be reviewed and reordered, so as to eliminate every opportunity for extravagance or waste, every excuse for inefficiency, and indifference. The evil of corruption in public service is also on the increase. Government is alive to its mischief; but so long as there are profiteers and black marketeers who can afford to give bribes, so long as there is chance of a better paid employment to public servants outside Government service, this evil of increasing dimensions and widening repercussions would be difficult to check and still more difficult to eradicate.

Another new development in the Public Expenditure of India may also be taken note of, though, in its origin, it is more a constitutional and political question than an economic problem.

The integration of several Indian States into existing Provinces, or the combination of other States to form unions amongst themselves, which, when formed, become new provinces, raises serious questions of fiscal policy and financial reorganisation which have yet to be considered and settled. This would perhaps be more fit to discuss in the Summary of Developments at the end of this volume; it is mentioned here, as, up to the moment of writing, no decision has been taken. The matter is under consideration, and accordingly only those aspects of it can be laid out here, which are germane to the main objective of this Series.

Before August 1947, administration in the States was, in most cases, far behind the corresponding level of progress or efficiency attained in British India. As noted above, in many Departments of social service, public utility, or economic development, the Provinces themselves differed widely **inter se**, and the best of them showed a very poor level compared to other progressive countries of the world. The States were, speaking generally, far behind even the most backward of the Provinces. The result is that even in the most advanced of them, considerable lee-way needs to be made up; and that would involve additional expenditure without any adequate or corresponding resources.

Wherever the States have become integrated with existing Provinces, as in Bombay, the Provincial Purse would have to meet the strain far more than the National Purse. On the other hand, States which have formed new Unions of their own, and which are now regarded as on a par with other Provinces, will, after pooling their resources, find their standard of efficiency in administration, of social service, public utility, or economic development so far behind their neighbours, that either their present resources would have to be very much extended, or far more substantial grants would have to be given them from the Centre. In a Federal Union of equal members, it would be intolerable that some are more developed than others, more progressive, more resourceful, so that they would for ever continue to keep ahead of others; and the latter would go on lagging behind. On a historic occasion Lincoln said that a nation cannot progress which is half slave and half free. We may adopt the profound truth of that observation by remarking that, after accession, assimilation or integration of the States with the rest of India, they cannot be suffered to remain backward and undeveloped.

The Central Revenues would certainly benefit to the extent that some of the Central Taxation, which has so far not been applied to the States territories, like Income Tax, will

now apply there also directly. On the other hand, whether or not any State Budget shows a surplus, considerable charges would have to be added on account of the Civil List of the Rulers. They have been promised to all the pre-Union and now mediatised Ruling Princes whose States have now become part of the Union of India or any Provinces thereof; and they are exempt from Income Tax. Whether the probable increase in revenue from these territories would be equal to increased obligations particularly in regard to making up the deficiency in the Social Services, Public Utilities and all round development of these areas, may be open to consideration. The chances however, are that for years to come, until the inherent resources and potentialities of these new additions to the Indian Union are fully explored and properly developed, the increase in Expenditure on their account would have to be much greater than any resources obtainable from that source.

There is a distinction, from the point of view of juridical position which reacts on Public Finance, between the territory and population of the States and those of the Provinces. There are still States which have not become integrated with the rest of India, or formed Unions to become new Provinces, and as such equal if not integral parts of the Union. Large States like Mysore, Travancore, Cochin, Kashmir, Baroda, Bhopal, Bikaner, Jodhpur, Jaipur, still remain distinct units by themselves. They have acceded to the Union of India only for the purposes of Defence, External Affairs, and Communications; and the finances necessary for those. The place of Hyderabad has yet to be determined, while a State like that of Cutch has been formed into a special Territory, directly administered by the Centre. For its financial resources, economic development and administrative efficiency the Centre would have to be responsible. For these States the problems of conflicting interest or jurisdiction and over-lapping sources of Revenue and Expenditure may still be important, especially in regard to Income Tax, Railway Receipts, Excise Revenue, and the like. Their existing Treaties, Agreements, or engagements regulating these matters would have to be revised consequentially upon the new set-up coming into force. Their relations with the neighbouring Provinces or States will also have to be similarly revised and reconditioned; and the financial consequences arising therefrom would have to be considerably adjusted.

These areas, though backward today in regard to all the matters mentioned above, have resources and potentialities of

their own which make the future far more promising than in the case of some of the more advanced areas. With the integration, assimilation or co-ordination of these States with the neighbouring units, the problem of planned development and responsibility for the entire Union, including the Financial Sector, would be much easier to discharge. In the past the States existing as distinct units, each by itself, independent in its local governance, made their own plans or programmes that might by special agreement be linked up with neighbouring areas, they might quite conceivably become proportionately difficult in so far as their interests did not coincide. That danger will now be obviated by the latest developments and the finances of the Union more simple to administer. To that extent also it would be easier not only to prepare an overall comprehensive National Plan; it would be simpler and more effective to carry it out.

IX. Use of Credit—National and Local—Its use and abuse.

The use of National Credit as an active instrument of achieving within predetermined stages social progress and economic development has hitherto been very much limited. The figure given elsewhere in this Introduction of the volume of Public Indebtedness is no indication of the potentiality of a proper development and economic use of this weapon. Taking the total indebtedness of the Central and Units' Governments at Rs. 3000 crores and without making any deduction for such assets as the accumulated volume of Sterling Balances, the ratio of the Debt is half the total National income of the Union at the present price level. The Interest charge on account of this Debt is about a tenth of the total Central and Provincial Revenues under existing conditions; so that the burden of Debt, and the incidence of Interest on that account cannot be said to be excessive. It is rather the wasteful or unproductive occasion for that Debt which is open to criticism; and if that is changed, and public credit used to develop potential resources actively the existing volume of Debt and the burden it imposes would be of no great significance.

Much of the borrowing, as has been pointed out, which was done during the British Regime, was for unproductive purposes of War, or meeting sudden emergencies like nation-wide famines, or grave calamities, like wide-spread earthquakes. Some productive assets are said to have been built up out of borrowed funds. Those assets are claimed to be self-sufficient in the matter at least of Interest Charges, like the Railways, the Postal Services and the Irrigation Works.

But the net surplus derived from these sources from their commencement to August 1947, the entire period of British Rule in India, was very slight, if any at all. These assets, moreover, were more services and facilities than productive enterprise proper, making direct addition to the sum total of the National Wealth. A programme of active development of Mines and Minerals, of Forests and Fuel, Electric Energy or large Industries of nation-wide importance, not to mention complete reorganisation of our agrarian economy, which would add substantially to the available volume of employment and also to the total wealth of the country, was scarcely ever considered as suitable for the State to attempt. That policy remains substantially unchanged still, though radical modification is inevitable. Even today such excursions as the State makes in the domain of economic development are confined largely to granting fiscal protection, service concession, facility or aid, trade agreements and expert advice and sometimes provision of capital or guaranteeing return. Enterprise remains largely in private hands, under private initiative and governed by the profit motive. Such enterprises as are taken up directly by the State, under the Central or Provincial Government, or a specifically established Statutory Corporation, are conditioned and limited in every respect, so as the least to interfere with or encroach upon private enterprise. The prospect, therefore, of deriving any net surplus from the State enterprise of to-day confined to public utilities and services, is limited. Even such new features as the production of telephone apparatus, air craft manufacture, or ship-building or operating shipping services are either jointly with private enterprise or left to private Corporations to manage, so that the fullest development possible to be realised from these sources remains untried. In a full-fledged National Plan of all round development, the role and use of public credit would have to be very much more direct and active.

On the Provincial plane also the use of Credit as a means of local development, is likewise restricted. Several Provinces have in recent years raised Loans of their own, and considerable volume of Indebtedness has been incurred largely in developing particular Services, providing facilities, or enabling ex-service men to be re-absorbed in the normal life of the country. Most of the Provincial Plans have definitely been made with a view to facilitate re-settlement of ex-service men. New wealth production or economic development that is expected under these Plans is incidental rather than intentional. Any programme of new wealth production by direct Provincial or Municipal enterprises is practically unknown.

Without complicating this Introduction any further by consideration of Constitutional or Political issues involved in the use of the National Credit as an engine of economic development, it may yet be stated that unless and until the entire Credit Machinery, including the Banking Service of the country, its instruments and technique are socialised, and used with a view to develop actively the potential resources of the Centre or the Units in farms and forests, factories and fisheries, mines and minerals, that instrument would remain, comparatively speaking, useless and barren. In every region, there is infinite scope for the active use of Public Crdit, and equal occasion to employ that instrument. Any comprehensive and consistent National Planning will have seriously to consider this problem of using National Credit as a means of active, direct economic development of the known, as well as of yet untried resources of the country, without which the fullest benefit of successful National Planning would not be available equally to all regions and classes of the country.

After this review of the Public Revenue and Expenditure as well as the potentialities of Public Credit, it is unnecessary, even if it were feasible, to present **pro forma** Central and Provincial Budgets in conformity with the main principles developed in this Introduction. As the Interim Report of the Sub-Committee points out, greater and greater attention would have to be paid to the development of new sources of revenue mainly from a proper development of Public Enterprise in productive sectors of our national economy, if a comprehensive National Plan for all round and simultaneous development of material as well as cultural resources of the State is to be prepared and executed. The Budgets of the local units and, still more, of the Union, would have to find more and more resources. It must provide, at the same time, for more and more expenditure on liabilities that a modern, progressive civilised community must shoulder. Properly handled, this would add to the sum total of the National Wealth, and at the same time improve the individual's standard of living, which must always be regarded as the primary aim of a scientific National plan.

X. Finance and Planning.

Immediately after World War II had ended, and a beginning was made in the transfer of power by setting up an Interim popular Government, the task of preparing a National Plan was taken in hand. A Planning Advisory Board was appointed to scrutinise the Plans already put forward by the

Central and Provincial and State Governments as well as non-official bodies and individuals; to recommend a scheme of priorities in the various items of those Plans; and to suggest a suitable machinery to administer the National Plan when finally prepared and put into operation. On the financial side that Board had estimated a surplus of Rs. 500 crores available in the Central Purse for aiding the Provinces in carrying out such Plans as they had prepared and were approved by the Central Government. Some of the Provinces had also built up their own resources from the spurious prosperity of war-time finances. The Indian States were then not integral parts of India. No account was accordingly taken of planned development in their territories or the financial assistance the Central Government would have to afford or liability undertake on account of those units.

Since August 15th, 1947, however, the States have either acceded to or been amalgamated with existing Provinces; or formed Unions of their own to rank as Provinces, and become equal units of the Union. The responsibility, therefore, of the Union Government for providing financial assistance is much greater, notwithstanding the Partition of the country into Pakistan and Union of India.

Within three years, however, of the end of the War any prospect of a substantial surplus in the Central Government has disappeared; and heavy and recurring deficit has become the order of the day. The Centre has had to face extraordinary emergencies, and meet proportionate demands on its purse; while the units have begun their onward march to make up the lee-way in those essential services and utilities without which no community can be called civilised. Existing resources are, consequently strained and new ones are hard to devise. Recourse to borrowing or creating currency becomes inevitable simply to meet current deficit. The additional responsibility on account of the integrated, assimilated or acceded States, makes the task still more difficult.

Unproductive borrowing which has added substantially to the Note Circulation, has introduced another complication in the shape of inflated price-level for such Plant, Machinery or Equipment as may be needed to give effect to the Plan. The increase similarly in the wages, salaries and allowance of Public Servants, or wage-earners in general engaged in carrying out the programme of industrialisation and planned development of every part of the country, makes the capacity of the Central or Provincial Governments to provide from current resources the aid or subsidy or the necessary

finance for direct State Enterprise, wherever undertaken by the Centre or any Unit, more than ever difficult.

Under these circumstances, the discovery, nursing and improvement of additional sources of revenue is much more important than would suffice just to cover current budget deficit. This will not be satisfied by merely increasing the rates of existing Taxation, as such an increase will not bring corresponding returns, and yet mean a disproportionately heavy burden on the taxable capacity of the people concerned.

The development of productive State enterprise which will bring real additional revenue will also take time. These enterprises, during their initial stages, would be rather a liability than an asset to the State. Expansion, improvement and extension of the Services, or Commercial Departments already conducted by the State in India, will thus become the first field for State initiative and plan. The foundation must be laid for such development as soon as possible. This can, however, not be done until the new Constitution is finally passed and put into operation. The linking of Provincial or Unit finances with those of the Centre, and co-ordinating the entire machinery and its activity for a planned development, would have to follow necessarily the distribution of financial resources and obligations as between the Units and the Centre.

K. T. SHAH.

INTERIM REPORT OF THE PUBLIC FINANCE SUB-COMMITTEE.

The Sub-Committee of the National Planning Committee appointed to consider the subject of Public Finance, had discussed certain specific issues and propositions embodying the sum total of the subject referred to above, and decisions were taken on these by the Sub-Committee, in a series of meetings held at Allahabad early in January 1940. These decisions have formed the basis of the Sub-Committee Report, the individual decisions being briefly expanded so as to bring out the idea more clearly wherever necessary.

The lack of time at the disposal of the Committee due to the demand of the National Planning Committee that all Reports of Sub-Committees be submitted, at the latest, by the 15th of March, 1940, is mainly responsible for the Sub-Committee's inability to present a more elaborate Report. But the Sub-Committee trusts that the interim report as this document may well be described will serve its turn for the purpose of preparing the outline of a comprehensive plan, such as is contemplated by the National Planning Committee.

It may be added that the Report deals with the several divisions under which the subject of Public Finance is usually treated, that is to say, Public Expenditure collectively for the whole of India, including the Central and Provinces' expenditure revenues to meet this expenditure; distribution of resources and obligations as between the National Authority and that of the constituent parts, and the use and mechanism of public credit.

I. Expenditure.

1. In the present system of Public Expenditure there is considerable room for retrenchment by means of

(a) Reconsideration of the governing policy regarding nature and object, strength and equipment of certain services like Defence or charges in connection with public debt. For instance by converting a more costly loan or form of debt into a less costly one. But this means the aggregate amount payable in a given number of years, as well as on the whole, may be reduced and the process results in substantial savings.

(b) Reduction in the scales of rates of pay, pensions, and allowances to Public Servants, in all departments, in the higher ranks. A considerable saving can be effected in this behalf by scaling down all salaries of public servants over Rs. 500 per month, if a maximum limit is fixed in respect of such salaries for all departments and ranks of public services. The sub-Committee would also like to add that, in conformity with the basic principles of the Plan, and in mere fairness to the large army of the lower paid public servants, a minimum living wage will also have to be fixed in all departments and ranks of the public service, if the plan is carried out in conformity with the principles indicated in the Hand Book of Information. This army of public servants will have to be very much increased in number and variety. The aggregate amount of expenditure, therefore, on this account will, on the balance, not show any deduction, but quite the reverse.

(c) Revision of the basis for fixing the strength and requirements of Public Service in each department, and for leave rules, particularly in the higher services.

2. All savings effected by revision, reduction of retrenchment are likely to be more than absorbed by

(a) Extending and widening the scope, direction, and volume of existing Public Service, including national defence.

(b) Increase in the number, variety and intensity of public activities. The Sub-Committee would mention in this connection the obvious necessity of increasing the volume as well as variety of **education** now provided. If every child of school-going age in the country is to be brought to school, and is to be kept there, for a prescribed period of six or seven years at least, as a fundamental right of citizenship, the strength and calibre of the Educational service would have to be increased out of all proportion as compared to the existing conditions. If a further increase is effected in numbers, and subject to the provision of a minimum living wage for all members of this Service, the aggregate expenditure on this account would be very considerably increased.* All this expenditure would have to be borne by Government, as, under the system of planned economy, little room will be available for private enterprise to assist in this field. The same

may also be said of other Social Services, such as, Health, Recreation, etc.

(c) Improvement of the basic minimum pay and conditions of service of the lower subordinate staffs.

3. For extending, widening, or increasing the scope, volume, or number of public services or activities, definite norms will have to be laid down by the Planning Authorities, and finance would have to be provided in accordance with the same, with due regard to economy and efficiency.

4. In Public Utility Services, though commercial principles may not be applicable in all cases, a thorough-going check and control by way of efficient audit is indisputable in regard to all items of expenditure. By this the Sub-Committee would convey that the Audit Department should not only see that due authority is available in regard to every item of expenditure incurred, while checking the accounts of all departments, but also that full value is received for every pice spent from the public funds. The Audit rules and the Audit Service will accordingly have to be completely and radically reorganised.

5. All items of expenditure, whether old or new, must be carefully correlated in advance with the purpose and programme of the Plan, and be made an integral part of the plan.

6. Items of expenditure of a reproductive character, or capital investment in utilities, services, or agricultural, industrial or commercial enterprises, must be kept apart from those of recurrent expenditure or revenue outlay.

7. In all cases of capital investment made out of borrowed funds, adequate provision must be made from the start for a complete liquidation of the obligation incurred, including interest and the replaçement or renewal without incurring fresh obligations on that account, of the plant, machinery, stock or buildings requiring such investment, within a definite period. This implies that the loan out of the proceeds of which such an investment is made is to be liquidated during the prescribed period from the revenue of this undertaking. Adequate provision should also be made, by way of depreciation, for replacement or renewal of the plant, machinery or buildings, required for such undertakings. Needless to add that, while liquidating the loan, the interest due from time to time on that amount would also have to be paid out of the revenues of the undertakings.

8. No interference should be allowed with the provision made under the preceding head, and no transfer or borrowing

permitted from this account to meet current losses or deficit in the ordinary Budget.

9. Exception may, however, be made under specific rules, to allow borrowings from these Reserve, Replacement Sinking Funds, for capital investment in the extension or expansion of the same utility, service or enterprise, or for a similar purpose in cognate utility, enterprise or service, provided that full provision is made for the repayment and liquidation in full of such loans within a definite predetermined period.

10. In allocating items of Public Expenditure, every care must be taken that as far as possible all items of nation-building, service-rendering and wealth-producing character are entrusted to the Provincial Governments and sources of revenue including the right to borrow, adequate for these purposes assigned to them.

11. When Provincial Governments delegate to the Local Authorities under them, functions and assign sources of revenue, they shall do so under proper financial and administrative control.

II. Revenue.

12. The aggregate volume of Public Expenditure—national, provincial, and local—collectively as well as severally, would have to be very considerably increased in order to meet all the requirements of the Plan. Revenues would have, therefore, to be increased proportionately.

13. For the effective execution of a comprehensive plan, it would be necessary to increase the contribution from the several forms of Public Enterprise, including a thorough exploitation of the Public domain in lands, mines, forests, and the like, so as increasingly to supplement the revenues derived from taxation, direct or indirect.

14. The production and supply of all Utilities and services, which are of a national character, and possible to make into public monopolies, should be carried on by the Public authorities; and the net surplus, if any, derived therefrom be appropriated as current revenue. In this connection the Sub-Committee would point out that the interest of consumers of each service or utility should be duly taken into account, particularly by the monopolist undertakings. The monopoly, it need not be added, is likely to increase the net surplus, as well as, the gross receipts, by reducing charges so as to provide for wider and wider demand.

15. Industries concerned with the provision of the main plant, machinery fittings and basic raw material, for the pro-

duction and supply of these utilities, and services, should also be conducted as collective national enterprises.

16. All key-industries ("mother" industries, or those vital to the existence of the country and its defence) should be progressively nationalised, in so far as they exist to-day under private enterprise. In future they should be undertaken directly by the State, and administered by a statutory corporation created for the purpose. Industries which are already established under private enterprise, must be acquired by the State, and turned into a nationalised enterprise, subject to such compensation to be paid to the present owners of that enterprise as may be deemed just and proper.

17. Nationalisation of any industry, utility, or service, at present in private hands, should be accomplished allowing a reasonable compensation to the existing private owners.

18. There is room for considerable extension, expansion, and improvement in the production and supply of utilities and services now conducted as national monopolies, e.g., communication or transport services.

19. Without sacrificing entirely the ideal of service to the largest number at the lowest cost, these can nevertheless be made to yield a net surplus, or profit, because of the economies possible under large scale production and efficient management in all round co-ordination. The rates, fares or charges should accordingly be so framed as to permit of a profit or surplus consistent with the rendering of as large a service at as low a cost as possible.

20. For the full consummation of the complete plan, direct taxes on Incomes or Excess Profits, or on property like Estate Duties, Death Duties, Land Increment values, should be developed by increase in rates on a steeply graduated scale. The principle of Differentiation in the rates charged as between earned and unearned income will have to be accepted.

21. Income from direct taxation on income, Excess Profits, and inheritance taxes should be assigned to the provincial governments as far as possible, but should always be levied and administered by the Central Government on the advice of an inter-provincial committee, subject to a right of surcharge by the Central Government to meet specific emergencies.

22. In a comprehensive plan, Land Revenue should everywhere be replaced by an agricultural Income-Tax, with proper safeguards for exempting a basic minimum and providing a graduated scale of taxation. It must be a wholly provincial source of revenue.

23. Taxes on House property, or Urban land, on Trades and Professions, and License Duty should, ordinarily, be assigned to local authorities.

24. All customs and Excise Duties should be assigned to the Central National Government exclusively.

25. Adequate Provision should be made for relief of Double Taxation within the country itself, as between units and units, and a unit and the Centre.

III. Credit.

26. Adequate credit facilities must be placed at the disposal of every governing authority—local, provincial,—to facilitate their undertaking productive enterprise left in their charge, with proper regulations for the safeguards of public credit. The Sub-Committee would add that for this purpose, a National Investment Board, must be established, through which alone, public borrowing for such purposes as may be indicated in the plan may be undertaken.

IV. Accounts.

27. Independent Audit for the Accounts of all governmental bodies and statutory corporations should be provided. in addition to local and internal audit.

MINUTE OF DISSENT BY MR. A. D. SHROFF TO THE INTERIM REPORT

Bombay House,
Fort, Bombay.
13th March 1940.

K. T. Shah Esq.,
Chairman, Public Finance Sub-Committee,
The National Planning Committee,
Bombay.

Dear Sir,

I have to acknowledge receipt of your letter of the 11th instant with a copy of the Interim Report prepared by you in consultation with the Honorary Secretary of the Sub-Committee.

2. I regret my inability to subscribe in substance to this Interim Report. As I could not be present at the Meetings of the Sub-Committee held at Allahabad on the 2nd, 3rd and 4th January, 1940 at which the main propositions embodied in the Interim Report were discussed and agreed to, it is not possible for me to share the responsibility for these decisions.

3. I may, however, outline in brief my considered view on some of the propositions in the Interim Report.

4. It appears that the underlying basis is the adoption by the State of a policy of nationalisation of industries in the country. I have consistently felt that the adoption of such a policy, except in the limited sphere of what may be described as Defence Industries, would be most detrimental to the main objective of the National Planning Committee, namely, to work out a well-thought-of plan for a rapid industrialisation of India with a view to raise the standard of living of the crores of men and women living in the country. I am afraid the recommendation of a policy of nationalisation will only result in severely discountenancing men of enterprise and means to undertake any further industrial ventures. This, in my opinion, would be particularly deplorable as, whilst in actual practice the ultimate effective implementation of this policy might not fructify for many long years to come, even the hope of a gradual promotion of new industries and expansion of the existing units is more likely than not to be seriously checkmated by a very natural fear that the State might in time intervene and deprive those who show initial enterprise and risk

their capital of the benefits which should rightly accrue to them.

5. Under the heading "Expenditure" 1 (a), it is estimated that "substantial savings" could be achieved by conversion of costly loans into less costly ones. A close examination of the outstanding loans which form the public debt of India does not justify this estimate. On the other hand, I should expect a very substantial increase in the borrowing rates, both for Central and Provincial Governments, if the policy of nationalisation is to be adopted and if both these Governments are in future to extend those social services like free and compulsory education, larger and wider medical and hospital facilities, health insurance etc. which are so badly needed for the general uplift of the vast masses of this country.

6. Under the heading "Revenue", item 21, the Interim Report suggests that income from direct taxation on income, excess profits and inheritance taxes should be assigned to the Provincial Governments as far as possible. I am unable to see how the Central Government would ever be able to balance its Budget in India if this suggestion is accepted.

7. I submit that in the enunciation of the various propositions embodied in the Interim Report very little regard appears to have been paid to the practical implications of these propositions, and I feel that a more detailed examination of these propositions in the light of practical test that may be applied to them will reveal the necessity of modifying them to a very considerable extent.

Yours sincerely,
Sd. A. D. Shroff.

MEMORANDUM FOR CONSIDERATION FOR THE PUBLIC FINANCE SUB-COMMITTEE

By

PROF. K. T. SHAH

It is impossible to give any similar account for the principal States in India, though it may be said that their revenue and expenditure contain most of the items on both sides mentioned above. The aggregate revenues of all the States of India have been estimated at about Rs. 60 crores and the expenditure is more or less equal.

Of the items of expenditure contained in the revenue and expenditure account as given above:—

(a) Those, which may be described at all of a nation-building character relate to Education and Health, Agriculture and Industries, Public Works, including Roads and Railways, Irrigation Works and the Post Office with all its services of telephones, telegraphs, parcels, etc.

(b) Of these, Railways, Post Office and Irrigation Works may be regarded as of a self-balancing character, and may be regarded as capable of considerable expansion by improvement in the services provided for them, and consequently, without any increase in the rates. If the rates are increased, though the expansion may be greater, there is always the danger of the demand falling off in a monopoly service when the monopoly adjusts the prices to suit its needs of a surplus, rather than to suit the principle of rendering the maximum of service without loss.

(c) Of the items which may be regarded as of a wasteful, unproductive nature, the most considerable is that of the Army or Defence Services. Certain branches of general administration,—particularly in the higher services, with their excessive scale of salaries and allowances including pensions payable to the personnel, often Foreign, engaged in such Services, may also be considered as being, essentially, of the same kind.

This does not mean that in a self-governing independent India, there would be no such items at all. All that it means is that the charges on such heads should be so revised as to bear a reasonable proportion to the ability of the Indian people, and the value of the service rendered.

(d) Items of a reproductive character included in the foregoing list are very few in number. They may be said to consist in the development of Railways, of Irrigation Works, and such expenditure as that on the Reserve Bank, Forests and the like. All these may involve considerable present investment, if an intensive policy of developing the national resources is undertaken; but they may well be calculated to yield, in course of time, a handsome surplus after meeting all current charges and so make a return more than equal to the investment made to it.

With the object of helping in the task of nation-building, and developing the resources of the country all-round, it may be desirable to develop particularly certain items of public expenditure like those on Industries, Health or Education, Irrigation or Roads, Forests or Railways, Post Office and Reserve Bank.

At the same time it would be desirable to discourage or reduce expenditure under the head on Defence Services, as well as in regard to the scales, grades, or rates of salaries and allowances in all public services in all departments, which may be considered to be of an excessive character.

We repeat that it is not intended that these items of expenditure will not exist in the planned economy of India, or will not be increased. All that is intended to be conveyed is that these are items which would need to be revised so that each individual item of cost is in conformity with the ability of the people, as well as in proportion to the value derived therefrom.

As regards the expansion of some other items, which need to be considerably developed with a view to bring up to a minimum standard the scale of living within the country, we consider it absolutely necessary that the following items, at any rate, should be expanded progressively, so as to reach within a prescribed period (say of ten years) a standard mentioned. These items are, Education and Irrigation, Industries, Transport and Communication Services, Insurance and Banking, and, of course, Agriculture in all its branches.

So far as Education is concerned, the governing principle must be that the basic minimum of education must be provided free of cost to every child born in the community, and of the age period 7 to 14 or 15. On this basis alone, the present volume of expenditure on Public Education would have

to be increased, at the least to about 3 or 4 times the present volume.

The increase would not merely be in the numbers at school, but also in the length of the compulsory school period, as well as in regard to the number of teachers, and their standard of remuneration needed for an efficient discharge of this duty. With all possible economies, this would necessitate a very considerable increase of the present total expenditure on education from all sources, to perhaps three times the amount now being devoted to that purpose, if not more.

Incidentally, the scale of teachers' salaries, the number of teachers employed, the number and distribution of the school buildings, their equipment, etc., would also require considerable expansion, not only of the expenditure incurred by the State directly, or through its representatives—the local bodies,—but also of the industries connected with the supply of such requirements.

The total increase will take place only after 10 or even 15 years; but a rapidly progressing increase will have to be provided every year.

The same may be said with regard to health services, including hospitals, sanatoria, nursing homes; and the personnel needed for the same, including doctors, nurses, and the like; as also the apparatus, instruments, drugs and medicines required for the service. The present outlay, both in the Provincial and the Central Governments on the health services of the country, will thus have to be expanded so as to provide at public cost all necessary care of health in every unit of 1,000 people.

It is difficult to say how this increase would show itself in figures; but we may take it that, as in education, so in this case, the present outlay would have to be doubled or trebled at least, not withstanding all economies that may be carried out with a rigid hand, in regard to the scale of pay, the grades of services, the number and nature of allowances, etc.

The same may apply, in greater force most likely, to the other developmental expenditure listed above.

The definite extent to which such services and expenditure thereon would have to be increased must be laid down in advance by some determinate objective, e.g. the provision of a Basic Minimum Education for 7 years, compulsorily and free of cost, to every child born within the community, and within a period of ten years from the date that the Plan comes into effect. If such objectives are definitely laid down, in regard to health, transport, communications and other ameni-

ties or comforts of civilised life, it would be relatively easy to indicate the volume of increased expenditure in the aggregate necessitated in the enforcement of the Plan.

Expansion in the Defence and other associated services may also be needed by a self-governing and independent India, but the extent and nature of such expansion, it may be difficult to forecast at the present time, when the existing scales of grades, and rates of pay provide no model whatsoever on which calculations may be based by a free India.

The extent of development in the particular branches mentioned above, which we regard as of a nation-building character, or in which substantial improvement of the material resources of public utilities is involved, would be so considerable that it is impossible to accomplish this by mere readjustment, reduction, and retrenchment in the present expenditure.

As far as we can foresee, at present, if all the developments were carried out as per Plan, upto the extent we have indicated in each case above, the present aggregate Budget of the country including the National and Provincial Governments, the States and Municipalities or local bodies, running into something like Rs. 400 crores, will have, at least, doubled though not necessarily by and for the same authority; but will be distributed all over the country.

Four hundred crores may represent something like 20% on the total present annual wealth or production in the country of about Rs. 2,000 crores; and Rs. 800 crores, with the national wealth increased by at least twice its present volume, —and still more, perhaps in its present ability to satisfy the primary needs of the people,—would mean a much less burden in effect, than the same proportion today. For, while Rs. 400 crores taken from Rs. 2,000 crores leave to the people Rs. 1,600 crores, while Rs. 800 crores taken from an aggregate production of Rs. 4,000 crores will leave Rs. 3,200 crores to the same number of people, i.e. from a per capita wealth of Rs. 62½—1¼ to Rs. 125—2½ per head.

It must also be added that the Rs. 800 crores in the aggregate, which we may anticipate as the likely extent to which the volume of public expenditure would have to be increased including expansion in nation-building services, in the next ten years, would, of course, include all retrenchment and readjustments, and reductions in the scales and grades of salaries and allowances, curtailment of expenditure on non-productive, wasteful objects and the like. Hence the then Rs. 800

crores will represent a very much larger volume of public service than only twice the present value.

The heads of Expenditure which in our opinion admit of retrenchment or economy, either collectively or in the scale of unit charges which at present obtain, are mainly comprised of the so-called Defence Services, and in regard to the pay and allowances of the personnel, particularly in the higher services. The detailed savings possible to effect by readjustment of excessive scales of pay and allowances, and curtailment in wasteful or non-productive expenditure may be difficult exactly to estimate. But a saving of at least one-third in the Defence Expenditure, and another third at least in the other services by mere readjustment of the scales of pay, etc., may result in a saving of at least about 50 crores, distributed as between the Provincial and Central Governments. This does not include the Railways and the Post Office, which, again, may contribute another 20 crores of savings or render a much greater volume of service for the amount now spent. But it must be added that all these savings and any more that may be possible to effect will be more than absorbed by the expansion which we have suggested above.

Regarding items in the Central, Provincial or State expenditure, which need to be fundamentally reviewed from the standpoint of their basic justification, the most considerable amount is by-way of the so-called Home Charges. These aggregate over 40 crores in the accounts of the Government of India. If we add other invisible payments from India of this kind, the amount would be much greater.

Not the whole of these amounts can, of course, be dispensed with altogether. But, items like the War Office Charges, or those in connection with the Pensions and Leave, etc., allowances to public officers residing outside India, or the scale of interest charges and repayment dues on the foreign debt of India, may all admit of very considerable scaling down, if not wholly dispensed with.

In opposition to the items mentioned above, there are other items in the Central, Provincial or State expenditure, which may have to be very considerably increased, even though some of them are neither productive, nor of a nation-building character. These, as already hinted above, may be comprised in the so-called Defence Services or Public Utility services like Education and Health. The former is under the charge of the Central Government, and the latter in charge of the Provincial Governments. The extent to which these may have to be increased is not easy to indicate, in-as-much

as such increase will depend upon the fundamental policy adopted by the self-governing India of the future, which cannot be foreseen in all its political implications and complications today.

Expenditure incurred by local self-governing bodies on items of a utilitarian character, and for services needed for nation-building, can, indeed, be woven into a single pattern with the amounts spent by the Provincial or Central Governments. It is, however, necessary, in order to make local self-government a real fact of daily life by every citizen, that this expenditure should remain apart, and should attract the attention of the citizens at every stage. Rendering Public Utility Service and conducting industries in connection with those Services would, it may be added, add to the resources of these local self-governing bodies, and so improve the financial position and make them offer a corresponding relief to the Provincial finance.

At the present time, the finances of the Local Self-Governing Bodies are dependent upon grants or subventions from Provincial Governments. These grants or subsidies are given on specific conditions and for particular objects, that materially reduce the field for real effective self-government. If the local self-governing bodies are, accordingly, encouraged to develop their resources of the type mentioned,—viz. conducting Public Utility Industries and Services which may be made to pay for themselves and yet bring a surplus,—their resources would be amply replenished, and the Provincial Governments relieved in proportion.

Subsidies from the Provincial purse would then either be unnecessary, or would be restricted to such local bodies, as, from their own resources, are unable to develop any considerable productive enterprise. Such subsidies would be earmarked for specific purposes.

The principal sources of revenue of the Central, Provincial or State are given in the table at the top of this memorandum. These sources may be classified as:—

(a) income from public domain;

(b) profits of services rendered, or enterprise conducted by the State;

(c) taxation; and

(d) departmental receipts.

While (a), the income from public domain is in the nature of the improvement of available exploitation of the national wealth, directly owned and conducted by the State, (b) pro-

fits from Public Enterprise,—such as Railways or Post Office,—are in the nature of monopoly dues, or concealed taxation. This, however, may not be felt in proportion as the service is at least equivalent, if not more in value than the amounts paid.

(c) Taxation on the other hand is a compulsory contribution from the private wealth of the citizen, which stands out in sharp relief against the surplus gained in public enterprise. While the latter is so much addition to the total wealth of the community, and, therefore, of each individual also, the former is a compulsory deduction from the private wealth of the individual.

(d) The departmental receipts, finally, are incomes derived from the rendering of services incidental to the conduct of certain public departments, to the citizens, for which certain fees are charged. These fees may not amount to equal the cost of the whole departmental cost of rendering the service, but which nevertheless, is sufficient for purposes of permitting regulation and control at the hands of Government all those who avail themselves of such service.

Several sources of public revenue overlap as between the Central and Provincial Governments in a number of cases. Excise duty or Sales Tax and Tax on Employment and Professions, may certainly be cited as examples of such possible overlapping between the Central and Provincial Governments.

As between the several Provincial Governments, the burden of the Income Tax may also be said to be overlapping, as residents of one Province may have properties or earning assets in another, and, as such, there would be double taxation. All common national services, like Posts, Telegraphs, and Transport, may also indicate some room for such double taxation, if any of these is made the occasion for revenue being raised.

It is not possible, always, to avoid such 'Double Taxation' especially in such a large country treated as a single unit, even though made up of different component governments.

'Double Taxation' may also be possible, as between the Local Self-Governing Bodies within a Province, and the Provincial Authority or State Authority; e.g. Taxes on property, professions, trades, license duties for all kinds of activities, etc. The only remedy seems to be to define as accurately and as closely as possible, the specific room for such taxation assigned to each body and authority, so that little or no room is left for such overlapping.

The income at the disposal of the Provincial Governments is already claimed to be utterly inadequate for the tasks entrusted to those authorities; and the same may be said with regard to the Local Self-Governing Bodies like the Municipalities. If a policy of intensive Education or Industrial Development, as well as provision for adequate Health Insurance facilities and sanitary measures is undertaken, the resources of the Provincial Governments, as well as of the Local Bodies, would be far below the requirements. On the other hand, the Central Government, too would be placed in the same quandary, if the Defence Services, and other non-productive expenditure in their charge, is similarly expanded.

The only manner, then in which amounts and revenues derived by the Central or Provincial Governments can be really increased is by cultivating and expanding the productive utility services or enterprises of the various governing authorities. We would suggest that all kinds of Industrial and Commercial enterprise, as well as Public Utility Services, which admit of a monopolistic basis, should be entrusted to the appropriate governing authority, so as to add by means of surpluses from such undertakings, considerable fresh resources to the revenues of the authorities concerned.

In the existing sources, also, there may be room for expansion by increasing the rate, or widening the scope of the service rendered, such as, Income Tax and Stamp duties, or Postal and Transport rates, and the like.

The addition of an agricultural income tax, so long as private property in agricultural land remains, and also the imposition of Death Duties and Estates Duties, with a view progressively to reduce the room for private property in land or moving wealth, would also add to the resources up-to a limit.

There is, likewise, room for an 'Excise' on industrial production, which may similarly be treated as capable of further expansion. Revenue duties on the articles of foreign trade, both by way of export or import, may, likewise, be expected to yield considerable amounts. The Export articles taxed must be in the nature of practical or effective monopoly of this country; and, on the side of imports, they are articles of such nature, that their consumption would not be reduced appreciably because of these duties.

On the whole, however, totalling possibilities of all these sources of expanding public revenue, at the disposal of the various governing bodies to-day, we don't think the aggregate of such expansion would suffice to improve all the in-

creased needs and requirements, both of the Central and Provincial Governments, not to mention the Local Bodies which would be expected for carrying out the Plan in all its departments.

We have already indicated our opinion that Public Finance be progressively based on a policy of substituting revenues from taxation,—particularly the indirect taxation falling unequally upon the poor and rich shoulders,—by profits of public enterprise and utility services, conducted as monopoly by the State or its various organs of Governments, so that, while adding to the total wealth of the community, the State takes its share directly from such increased wealth.

There is a vast field of public domain in agricultural land, in forests, in yet unexplored mines, and all kinds of public utility services,—to mention only a few of the obvious lines in which such a policy may be immediately given effect to,—which, properly cultivated, would yield a greater portion, if not all the increased resources, necessitated by the Plan advocated above.

Revenue resources particularly taxation can be utilised effectively for bringing about a silent and steady redistribution of the national wealth of the community. All taxes on income on progressive scale, reaching up to an effective confiscation of incomes over certain grades, death duties, of a progressively high rate, excess profits, duties, estate duties, confiscation of increment in land values, or heavy taxation of such increment are all means by which a progressive, though silent, redistribution of the national wealth may be effected.

In so far as the resources thus obtained are utilised for promoting public utility services rendered free or at very low cost to the Public necessitated,—e.g. education to be compulsory up to a minimum standard to every child, sanitation of a required predetermined standard, housing and other services,—this redistribution would be in an indirect or concealed form, which, however, would serve its purpose.

Introduction of a National Insurance provision for the working population, limitation of hours of work, and prescribing conditions of work and work rooms, together with the provision of old age pensions, and all other social security services for the individual, would likewise, raise the standard of living of the lowest paid strata in society at the expense of those who have a disproportionate command of the resources of the country.

In this manner, if private property is maintained even in the Planned Society, it may be possible to bring about a cer-

tain degree of silent redistribution of the national wealth, so that the taxation would be more equitably apportioned, and more in accordance with the ability to bear the burden, while the services or benefits would be provided in a measure corresponding to the needs of the people, who have to benefit from such service.

The forms of public enterprise, Industrial, Commercial, and others, which are possible to develop progressively to replace sources of present public revenues may be described as consisting of Public Utility Services, such industries as admit of large scale monopolistic treatment, particularly in the industries like ship building, railway wagon making, cinema films production, etc., and cultivation of waste land, development of forests and unexplored mines. These may need considerable capital investment and also require co-ordination, so as to avoid unnecessary competition or wastage of national energy. Public services such as that of transport by Road, Rail or River, as well as Air; that of communications including Posts, Telegraphs, Telephones, Wireless and the industries ministering to the same; housing and building industries, banking and insurance, also admit of a co-ordinated large scale nation wide operation which would result in considerable surplus of profit to the State, or its representatives conducting such services.

It is impossible to give an exact idea of the amount that may be derived by the State, or its representatives, from such enterprise, but if properly cultivated, there seems every hope that these may result in substantial addition to the wealth of the community, and therefore, to the amounts at the disposal of the Government.

At the present time, the Land Revenue, Excise, and Customs Duties and Income Tax,—to mention the most salient items,—press with uneven burdens upon the people actually producing wealth. At least, in the higher brackets of income, and in many forms of income, not only there is evasion or avoidance of the tax; but the rate, even when the tax is paid, is as one so disproportionately different in its incidents as between the different strata of income, that the equity of taxation can scarcely be said to be maintained.

In regard to Agricultural Land also, the same difficulty arises, so far as Land Revenue is concerned, whether it is direct demand of the State, or is paid in the form of rent through Zamindars, Taluqdars, Malguzdars, or other forms of intermediaries. The system of demanding land revenue in cash in a fixed sum over a long term of years, (20-30) irrespective of seasons, irrespective of the size of the holding and

the number to be supported thereon, has naturally intended to make the burden of land revenue far greater than even that of the income tax, particularly that of the small producer.

Customs and Excise Duties being indirect taxes, also fall with unequal emphasis upon the small consumer, who has to pay the increased prices because of these duties, as most of these are necessities of life. And so the burden is much greater than can be appreciated from the mere amounts of the revenue.

Salt duty, which is practically a public monopoly of the Government of India and from which considerable amounts of revenues are derived is another which fall upon the small consumer.

The Sources of Revenue placed at the disposal of the Local Self-Government Bodies, like the Municipalities or Local Boards, which are capable of being expanded so as to provide adequate funds for carrying on such services and functions the Local Self-Governing Bodies have been charged with, consists of rendering such Public Utility Services, as for instance, Transport in all its forms, communications like Telephones, supplying of Light and Power by Gas or Electricity, provision of markets, slaughter houses, and the like. These are all in the ordinary scope of their duties, and can be made to yield additional revenues, if only the local self-governing bodies realise the possibilities inherent in such enterprises. A Local Municipal Bank in the larger towns, with a full compliment of incidental services; and local enterprise in the supply of Sports Grounds, Amusements including picture houses or Cinema enterprises, Eating Houses, Laundries, Public Baths, Boating clubs wherever the natural facilities permit such enterprise, and a host of other directions of expanding public enterprise are available to many such local bodies in India, which can be made, not only to render the widest public service to the local public, but also to yield, incidentally, by the rendering of such services, considerable resources of revenue, which is to-day taken away by private profit-taking enterprise operating in these fields.

The services, also, of a non-productive character, which will devolve upon the local bodies to carry on,—such as, Education, Sanitation, or Housing,—may require very much increased expenditure than at present. These cannot be self-sufficient and must, accordingly be provided out of these expanded resources. For the subsidies, at present paid by the Provincial Governments in aid of such services will never be

adequate, even if they are continued, to meet these manifold requirements of an expanded local enterprise.

We consider it, therefore, necessary to develop these services and enterprises, by properly co-ordinated local self-governing units, mutually co-operating and co-ordinated, so as to render the widest possible service, and yet obtain the largest possible revenue for these bodies.

The exact extent to which these revenues may be increased is difficult to forecast, but, we have no hesitation in holding that the present local revenues would be more than doubled, in ten years, if only these enterprises are properly developed.

In order, however, to carry on these enterprises, profitably and successfully, from the point of view of the fullness of service rendered, local self-governing bodies would have to be regrouped, so as to make the area of operation, as convenient and as economic a unit as possible. In delimiting the unit area, we have to consider not only the geographical extent of the area to be served, but also the number and character of the population living in that area, and ministered to that local self-governing body.

While it is impossible to lay down in advance any standard unit to be observed all over the country, it is possible that in each part of the country, in each province, such units may be conveniently determined approximating to one another, in size as well as in strength of population, so as to permit the operation of this service on the most convenient and economic basis possible.

So far as the revenues and obligations between the Provincial Governments and the local self-governing bodies are common, they necessitate a division of resources and obligations between the two authorities. We consider it advisable to place at the disposal of the Local Self-Governing bodies all those resources, which are of a productive character, or consist in rendering services and providing utilities which must be paid for and so may yield a progressively increasing surplus. By these means probably all the needs of the locality can be met out of such additional resources. For the Provincial Governments, as far as possible, revenue resources reserved should be of the nature either of direct taxation, e.g. Land revenue, Agricultural Income Tax, Death Duties, or in the nature of public enterprise of a province-wide character. Such enterprise may consist of co-ordinated transport service throughout the province; supply of roads and road materials,

production and supply of electrical energy on a province-wide basis; carrying on of monopolistic industries; or cultivation of such waste-lands as are not in cultivation to-day, but are capable of being brought under the plough, so as to increase considerably the net revenue of the Province.

So long as the regime of private property is maintained, the Provincial Governments will have to obtain a large slice of their requirements from taxation of property, income, and such acts of trade or commerce, profession or occupation, which admit of easy taxation without violating the well-known canons of sound finance in individualistic society.

By this method all the requirements of sound and efficient administration, democratic self-government, and economic management of public resources, would be fulfilled, as between the Provincial Governments and the Local Self-Governing units, so that the sum-total of the public welfare will be enhanced much more than the actual volume of the monies thus spent by these several authorities would indicate.

In this manner,—that is to say, by undertaking as a collective responsibility, a wide range of productive enterprise and utility services,—the State or its representatives, the Provincial and local self-governing bodies, will be in a position to create an ever widening range of employment, absorbing an ever increasing proportion of population that at present impinges upon the soil as practically a deadweight, impossible to be maintained except on a rapidly declining level.

The undertaking of all such enterprises and services would have to be financed, in the first instance, by some adequate and efficient means, a serious question for every public authority to face. We consider it, however, not impossible to obtain capital resources, both at home and from abroad, which would be more than equal to meet all the reasonable capital needs of such enterprises and services. The various deposits and reserves of the Banks and Insurance Companies, and the power of the Central credit organisation of the country,—the Reserve Bank of India,—joined to the volume of deposits in the commercial banks, post office savings banks and other forms of reserves of small or large industrial and commercial corporations, may well be said to provide a nucleus for obtaining the necessary finance for the successful undertaking and prosecution of these enterprises and services.

The aggregate volume of known reserves of this character can be put at something like 300 crores at the present time;

of which over 80 crores are in the post office savings Banks and an equal or larger amount in the Exchange Banks, while another amount of the like kind is in the Reserve Bank and Imperial Bank. The balance can be said to be made up by the Insurance Funds, reserves of other companies, and those maintained for keeping up the currency system of the country.

All this amount is already available on a ready mobilised basis of capital reserves. They can be considerably expanded, if the National Currency and Credit system are centralised, co-ordinated, nationalised and reorganised, so as to provide the current capital in close correlation with the realised productivity of these services and enterprises.

It is impossible, indeed, to estimate the total amount of capital needed for undertaking and carrying on all the enterprises and services mentioned above. But, in the planned programme of the first ten years, we may well estimate the requirements of capital for providing such services and industries or enterprises at about 500 crores, which is not too large a capital amount spread over ten years. The main justification for undertaking these services and enterprises, moreover, lies not only in providing the amenities or goods at a much lower cost to the individual than is the case to-day, but also in such volume and so economically as to yield an ever increasing surplus, sufficient to cover the entire capital investment in about 5 years' time.

It follows, then, that over a period of ten years, the whole of this capital investment will be available for repayment from the surplus profits of all these services and enterprises, so that the burden and responsibility will not be too great to undertake..

We realise, indeed, that this is a very considerable utilisation of public credit. Its use in this direction will not be considered orthodox, nor have the weight of usage behind it amongst the individualist economists. In a Planned Economy, with proper co-ordination, regulation and control from some central authority, much of the dangers that may be anticipated from such a use of public credit would of course, be automatically eliminated by the mere fact of such co-ordination, regulation, and control.

Such dangers as may, nevertheless, be anticipated, because of this use of the public credit in such volume may be guarded against by laying down conditions of providing adequate reserves, both by way of depreciation and sinking funds, so as to pay for the capital charges within a prescribed period.

A 10 per cent reserve for capital repayment, in addition to a 10 per cent provision for depreciation or repairs and renewals of plant, machinery, etc., would only mean a total volume of net surplus from such enterprise of 20 per cent. This is by no means an excessive expectation from these services, or enterprises of a productive character.

On this basis, it is possible, not only to pay off the capital charge in a period of ten years, but also to provide a Reserve Fund for the wholesale renewal, if necessary, of all the plant and machinery employed in such enterprises or services, that may need to be replaced by the progress of Science and Invention.

Careful supervision and control by the Central authority would not only be necessary to see that these provisions or safeguards are complied with, but, at the same time, to see that the prices of the commodities or services supplied are kept within reasonable limits, so as to be well within the means of the average citizen intended to be provided with such amenities.

Reorganisation of Public Credit on this basis, and its linking up with the national system of Currency, including the reserves supporting these currencies, in the last instance, would afford an evergreen source of replenishing the liquid capital strength of the country, so as to meet all fresh requirements, as and when they arise; and at the same time to promote productive enterprises of all kinds as the Planned Programme requires.

N.B. The Tables attached to this Memorandum giving the Revenue and Expenditure of the Central and Provincial Governments relating to the earlier years when the Planning Committee started work, are now out of date, but have been replaced by more uptodate figures given in the Introduction. These Tables, therefore which were attached to the Memorandum are omitted.

RESOLUTIONS OF THE NATIONAL PLANNING COMMITTEE ON THE REPORT OF THE SUB-COMMITTEE FOR PUBLIC FINANCE

The Interim Report of the Public Finance Sub-Committee was presented by the Chairman of the Sub-Committee, Shri K. T. Shah on the 24th June. There was a minute of dissent by Mr. A. D. Shroff, which was read out by the Chairman, National Planning Committee. Discussion continued on the 25th June.

The Chairman of the Public Finance Sub-Committee informed the N.C.P. that the Report was agreed to by five members of the Sub-Committee, namely, Dr. D. R. Gadgil, Prof. C. N. Vakil, Prof. Gyan Chand, Dr. J. P. Niyogi and himself, who were all present at the meetings of the Sub-Committee at Allahabad. Messrs. Qureshi, Thomas and Venkatarangaiya had not been present, and they had not, so far, expressed their approval or disapproval.

He then explained the main features of the Report. In answer to questions, he stated that it was not possible for his Sub-Committee to give estimates of income and expenditure under this plan, as this would depend on the norms by the N. C. P. and the general policy of the State. If these norms were laid down, then an attempt could be made to give these estimates. Shri K. T. Shah was requested to prepare a note, on his own behalf, giving these estimates on the basis of the decisions of the National Planning Committee so far taken.

The following resolutions were then adopted:

I. Expenditure:

1. In the present system of Public Expenditure there is considerable room for retrenchment by means of:

a. *Reconsideration of the governing policy regarding* nature and object, strength and equipment of certain services like Defence or charge in connection with public debt;

b. Reduction in the scales of rates of pay, pensions and allowances to Public Servants, in all departments, in the higher ranks. In conformity with the basic principle of the Plan, and in fairness to the large army of the lower paid public servants, a minimum living wage will also have to be fixed in all departments and ranks of the Public Service;

c. Revision of the basis for fixing the strength and requirements of Public Service and in improving its efficiency in each department, and for leave rules, particularly in the higher services.

2. All savings effected by revision, reduction or retrenchment are likely to be only a fraction of the expenditure needed for:

a. Extending and widening the scope, direction, and volume of existing Public Services, including National Defence;

b. Increase in the number, variety, and intensity of public activities, e.g. Education;

c. Improvement of the basic minimum pay and conditions of service of the lower subordinate staffs.

3. For extending, widening, or increasing the scope, volume, or number of public services or activities, definite norms will have to be laid down by the Planning Authorities, and finance would have to be provided in accordance with the same, with due regard to economy and efficiency.

4. In public utility services, though commercial principles may not be applicable in all cases, thorough-going check and control by way of efficient audit is indispensable in regard to all items of expenditure and out put of work and value received.

5. Capital investment in utilities, services, or agricultural, industrial or commercial enterprise, must be kept apart from those of recurrent expenditure.

6. Against capital investment made out of borrowed funds, adequate provision must be made from the start for a complete liquidation of the obligation incurred, including interest, and the replacement or renewal, without incurring fresh obligations on that account, of the plant, machinery, stock or buildings requiring such investment, within a definite period. Adequate provision should also be made, by way of depreciation, for replacement or renewal of the plant, machinery or buildings, required for such undertakings.

7. No interference should be allowed with the provision made under the preceding head, and no transfer or borrowing permitted from this account to meet current losses or deficit in the ordinary budget.

8. Exception may, however, be made under specific rules to allow borrowings from these Reserve, Replacement Sinking Funds, for capital investment in the extension or expansion of the same utility, service or enterprise, or for similar purposes in cognate utility, enterprise, or service, provided that full

provision is made for the repayment and liquidation in full of such loans within a definite predetermined period.

9. When Provincial Governments delegate to the Local Authorities under them functions and assign sources of revenue, they shall do so under proper financial and administrative control.

II. Revenue:

10. The aggregate volume of Public Expenditure—national, provincial, and local—collectively as well as severally, would have to be very considerably increased in order to meet all the requirements of the Plan. Revenues, would have, therefore, to be increased proportionately.

11. For the effective execution of a comprehensive Plan, it would be necessary to increase the contribution from the several forms of Public Enterprise, including a thorough exploitation of the Public domain in lands, mines, forests, and the like, so as increasingly to supplement the revenues derived from taxation, direct or indirect.

12. The production and supply of all utilities and services, which are of a national as well as a monopolistic character, should be carried on by the public authorities: and the net surplus, if any, derived therefrom be appropriated as current revenue. The interest of consumers of each service or utility should be duly taken into account, particularly by the monopolistic undertakings.

Note: Mr. Ambalal Sarabhai desired it to be noted that while he agreed with the first part of this resolution, he was not agreeable to the surplus being appropriated as current revenue. This should not be the objective in view.

13. In regard to public utilities and services, the ideal of service to the largest number at the lowest cost, should be kept in view. Nevertheless, because of the economies possible under large-scale production and efficient management in all round-co-ordination, a net surplus or profit will probably accrue, and this should go to the public revenues.

Note: Mr. Ambalal Sarabhai, though he was in favour of nationalisation, doubts if it would be more economical or more efficient.

The sub-committee had recommended that industries concerned with the provision of the main plant, machinery fittings and basic raw materials for the production and supply of nationalised utilities and services should be conducted as collective national enterprises. Further that all key industries ('mother' as well as 'vital' industries) should be progressively

nationalised and administered by a statutory corporation created for the purpose. Private enterprises, so acquired, should be paid just and proper compensation.

The N.P.C. had so far decided that key industries should be owned or controlled by the State, the control being strict in the case of key industries. The possibility of such industries not being owned by the State but controlled by it has thus not been ruled out. This question had been left for future consideration when more data were placed before the Committee for any further decision that it might take.

It was pointed out on behalf of the Public Finance Sub-Committee, that apart from other considerations, questions of finance and the necessity for increasing revenue for the nation-building activities of the State made it essential for their being merely controlled should be ruled out.

The N. P. C. was of opinion that as this raised a question of fundamental principle, and the argument of revenue had not been previously placed before it, the whole question should be considered by it at a later stage when basic questions of policy were considered.

The Public Finance Sub-Committee had further recommended that in allocating items of public expenditure, as far as possible all items of nation-building, service-rendering, and wealth-producing character should be entrusted to the Provincial Governments and sources of revenue, adequate for these purposes, assigned to them. Incomes from direct taxation on income, excess profits, and inheritance taxes, it was recommended, should also be assigned to the Provincial Governments.

The National Planning Commitee referred back this last recommendation to the Sub-Committee for reconsideration and fuller examination.

14. For the full consummation of the complete Plan, direct taxes on Incomes, or Excess Profits, or on property like Estate Duties, Death Duties, Land Increment Values, should be developed by increase in rates on a steeply graduated scale. In levying taxation, the principle of redistribution of the burden of taxation in accordance with the taxable capacity should be given effect to.

Note: It was proposed to add the principle of differentiation between earned and unearned incomes also. Pending a clearer definition of unearned incomes, this addition was postponed.

15. In a comprehensive Plan, Land Revenue should be charged according to the principle governing Income Tax, with proper safeguards for exempting a basic minimum, and providing a graduated scale of taxation. It must be a wholly provincial source of revenue.

16. Taxes on house property, or urban land, on trades and professions, and the revenue from municipal and local licence duty, should ordinarily be assigned to local authorities.

17. All customs duties should be assigned to the Central Government exclusively. The question of excise duties requires further consideration, and was referred back to the Sub-Committee. If excise duties are to be levied, this should be done only by the Central Government.

Note: Mr. Ambalal Sarabhai wanted it to be noted that, in his opinion, Excise Duties on essentials of life are undesirable.

Salt Duty: As the Sub-Committee had made no recommendation about, or reference to, the Salt Duty, the National Planning Committee decided to ask them to consider this question from the economic as well as other aspects, and to report.

18. Adequate provision should be made for relief from double taxation within the country itself, as between units and units, and a unit and the Centre.

III. Credit:

19. Adequate credit facilities must be placed at the disposal of every governing authority—local or provincial—to facilitate their undertaking productive enterprise left in their charge with proper regulations for the safeguard of public credit. In the case of local bodies an adequate control must be exercised by the Provincial Government. A National Investment Board must be established, through which alone, public borrowing for such purposes as may be indicted in the Plan may be undertaken. This Board must work in close co-operation with the Central Banking Authority.

Note: Mr. Ambalal Sarabhai, Mr. Advani, and Prof. R. K. Mukerjee were of opinion that the Central Banking Authority should itself do this work directly.

IV. Accounts:

20. Independent Audit for the accounts of all governmental bodies and statutory corporations should be provided, in addition to local and internal aurit.

DRAFT QUESTIONNAIRE FOR THE SUB-COMMITTEE ON PUBLIC FINANCE

Q. 1. What are the principal items of Public Expenditure in the Budget of (a) the Central Government of India; (b) of the several Provincial Governments and (c) of the leading Indian States who have introduced some sort of a definite budgetary system in their administration?

Q. 2. What are the items, in the foregoing lists, of the Central or Provincial or State expenditure heads, which you would class as:—

(i) of a nation-building character;

(ii) of a wasteful, unproductive nature without any reaction on "nation-building";

(iii) of a self-supporting nature, where income and outlay balance one another generally speaking;

(iv) of a reproductive character, wherein present investment might repay itself even in material or monetary terms within a definite period.

What steps would you suggest for the particular cultivation, development, or discouragement of any of the *foregoing items, and with what objective in view?*

Q. 3. Are there any heads of Expenditure, in the present-day Budgets of the Central, Provincial, or State Budgets, which, in your opinion, would need to be considerably expanded in the near future? What are those heads of expenditure needing expansion in the near future? To what extent do you think such expansion must go, as estimated in figures, to fulfill the main outlines of the Plan?

Q. 4. What are the services, or occasions, of a developmental nature, wherein present standards of public expenditure in India are very inadequate; and which would accordingly have to be expanded? What is the limit of such expansion which you consider to be indispensable to reach in the near future at any cost?

Q. 5. What are items of a non-material character which also need to be expanded for reasons of progressive development of the country, and an all-round betterment of the standard of living of the people? To what extent is it

possible to attend to such items by readjustments in the existing outlay on other heads of public expenditure?

Q. 6. What are the heads of Public Expenditure, which you consider would admit of retrenchment or economy, in the aggregate, or in the scale of unit outlay at present in vogue? To what extent can savings be effected in these items in the Provincial, Central of State Expenditure? How would you suggest should such savings be diverted to items of a more directly developmental character without undue dislocation, or creating unnecessary discontent?

Q. 7. Are there any items in the Central, Provincial, or State Public Expenditure, which, in your opinion need to be fundamentally reviewed from the stand-point as to whether they are justified at all, and which may be dispensed with altogether?

Q. 8. Contra-distinguished from items in the preceding Question (No. 7) are there any items of Expenditure, in the Central, Provincial, or State Expenditure, which, in your opinion, though unproductive, may have to be increased if India is to be adequately prepared to maintain her national independence and integrity? What are those items? How far would they have to be expanded? Are there no other ways of effecting or achieving the same purpose without disproportionate increase in expenditure?

Q. 9. How far is expenditure incurred by Local Governing Bodies possible to be woven into a common pattern when a comprehensive Plan of National Development is undertaken? To what extent would such Local Expenditure by Self-Governing Local Bodies likely to cause a relief to the Provincial, State, or Central Expenditure?

Q. 10. To what extent is the Finance of Local Governing bodies dependent upon Provincial Subventions or Grants for specified objects? What treatment would you advocate for these Subsidies?

Q. 11. What are the principal sources of revenue for the Central, Provincial, and State Governments? How would you classify these sources? How would you differentiate between these several sources?

Q. 12. How far is the field of sources of Public Revenues overlapping as between the several authorities mentioned in the preceding Question? What steps would you suggest for avoiding or minimising the overlapping leading

to what might be called "Double Taxation" of the same individual, for the same service, or on the same occasion, or in respect of the same index of his taxable capacity?

Q. 13. To what extent is the income at the disposal of the several authorities mentioned in question 11 adequate for the functions of government and administration, as well as those in respect of Public Utility Services and Developmental obligations of Government imposed upon or entrusted to or assumed by the several authorities, any or of them?

Q. 14. In what directions, or by what methods, in your judgment, can the amounts of revenue derived from the several sources possible to be increased? How would you suggest should the sources themselves be expanded?

Q. 15. How far, in your opinion, is it possible and desirable to substitute public revenues from taxation by that derived from an extension, expansion, or improvement in the sources of income connected with Public Domain, Industrial Enterprise conducted by Public Authorities (Provincial, Central, or State) or Public Utility Services (or any of them) rendered on a commercial basis?

Q. 16. To what extent is it feasible to utilise sources of Public Revenues as a weapon for effecting a redistribution of the aggregate National Dividend on the basis of Equality so as to secure to every citizen or member of the community sufficient to meet all his needs even as taxation, or demand for Public Revenue is so adjusted as to take from each according to his ability in cash or kind?

Q. 17. What are the principal forms of Public Enterprise, Industrial, Commercial, or others of a like nature which, in your judgment, it is possible to develop so as progressively to replace the existing forms of tax-burdens by these sources of new wealth created by Public activity of which a share is taken by the Public Authority responsible for the creation of such new wealth to meet its non-productive needs?

Q. 18. To what extent, and in what manner, do the existing burdens of Public Revenues press upon the individuals,—or objects of wealth,—bearing those burdens, and with what consequences, especially in reference to the further development of the national wealth?

Q. 19. To what extent the sources of revenue at the disposal of the Local Self-Governing bodies,—apart from specific grants or subventions from the Provincial Governments,—capable of being expanded so as to provide adequate

funds for carrying on such services and other functions of Local Government as may be devolved upon them or may be assumed by them?

Q. 20. What regrouping of the various Local governing bodies would you suggest in order to make the resources at their disposal adequate for the functions that they may be saddled with or which they may assume in discharge of their duties? What division of resources and obligations would you advocate as between Provincial (or State) and Local Governing Bodies, so as to provide for an efficient discharge of Local Government duties and administration and at the same time ensure adequate resources being at their disposal?

Q. 21. How far is it possible for the State to create employment for the people? From what sources would the finance required for such activities, be provided for?

Q. 22. How far is the use of credit possible for the Central, Provincial, (State), or Local governing bodies to attend to the various duties that may be charged upon these several authorities or which may be assumed by them? What safeguards would you suggest for the economical and efficient use of public credit by any of these authorities?

Q. 23. To what extent is the control of public credit and national currency indispensable for the proper husbanding of the resources and obligations of the several public authorities mentioned above?

Q. 24. How would you recast the unit of account for keeping proper record of public receipts and disbursements, so as to apply not merely to the budget of individual authorities but also to the aggregate of national economy?

SUMMARY OF DEVELOPMENTS

The Chairman of this Sub-Committee being the writer himself, the Introduction to this Volume has followed a slightly different pattern from that to the other Volumes in this Series. Statistics as well as other developments have been included in the Introduction for as late a date as was obtainable. In the present Section, therefore, dealing with the "Summary of Developments", note will be taken only of outstanding facts or events of a more general character, which have their repercussions on Finance.

The principal events which have reacted on the Financial System of the country are:—

(1) World War II 1939-1945.

(2) Change in India's Debt position.

(3) Reactions of the War demand upon the country's Revenue and Expenditure.

(4) Growth of Sterling Balances.

(5) Partition of the country into Pakistan and the Union of India; and its reactions,—constitutional, political, as well as financial.

(6) Redistribution of financial resources—sources of revenue and obligations or items of expenditure as between the Union Centre and the Provincial or States Units.

(7) Accession, assimilation or absorption of Indian States in the Union and their financial consequences.

(8) Recognition of the need to plan the entire economy of the country to attain given objectives by predetermined stages, within a fixed period.

(9) Formation of Statutory Corporations.

(10) Developmental Finance.

I. War Finance in India—1939-45

During the six years of the War there was a heavy and steadily rising strain of war expenditure, and in consequence also increase in the civil outlay. Figures have been given in the Introduction to show the increase that had taken place. Considerable additions were made to the rates of taxation and

charges for Public Services in every direction, both at the Centre and in the Provinces to meet the increased demand; and new taxes were also imposed. The effect of these has been recorded, so far as statistics permit, in the Introduction.

War Finance in India was not determined all through the British regime in accordance with any scientifice principles of financing for such emergencies. Every time that such expenditure had to be incurred by the Indian Government in the last 90 years, they had to follow the pattern set up by Britain, without any consideration of the fitness of the ways and means for carrying on the War. This was even apart from the intrinsic justice of India engaging in such quarrels and bearing any share of the burden on her own shoulders: Little account was also taken of the nature and probable duration of the operations. It would be useless, therefore, to discuss the Ethics and Economics of war financing in India. Still less can one usefully consider the Politics of such ventures, since India had no foreign policy except what Britain forced upon her.

Under these circumstances, War Financing had invitably to follow the British model. In the latest case it was settled by an Agreement, made at the outbreak of the War, to regulate the share of the burden to be borne by India. Indian revenues had been expressly prohibited to be used, under the Act of 1858 for any extra-territorial wars that her connection with Britain involved. The Government of India Act, 1935, had, however, radically changed this position, and authorised India joining Britain's quarrels with other countries, even though they were no concern of hers, neither brought about by her Diplomacy nor likely to give her a share in any benefit resulting from such Wars.

Problem solved by Agreement

Several ways of meeting war expenditure have been tried by modern nations. Increasing the rates on existing taxation; adding new taxes, cutting down other expenditure, borrowing at home and abroad, have all been tried in the last World War by every nation engaged in it simultaneously. Lease-Lend, invented by the United States was a variat of the last form without its legacy of perpetual burden of unproductive debt.

In the case of India, however, the ground for her entering the struggle was so thin; the chances of her getting any benefit for herself by joining the War so slight, that the very share she should bear of this gratuitous burden had to be set-

tled by agreement. It was realised, even from the start, that not only would India have to bear a considerable expenditure for expanding her own military, naval and aerial armaments, together with their incidental, accessory or consequential services and supplies; but that it would have to make considerable loans of such forces, services, facilities and commodities to the Imperial British Government, to fight in the latter's battles far beyond the shores of India.

In addition, since this is a war of machines and materials rather than even of brawn and muscle, the War Effort would mean a considerable expansion in the industrial output and productive organisation of the country, to produce, procure or provide the necessary supplies of material and equipment, needed both by the Indian and British forces. The accessory services of transport by sea or land, or air, together with the adjuncts harbours, aerodromes, railway terminals; banking and credit, would have also to be re-oriented to meet wartime needs, and suit wartime conditions. The element common in all these to the British and the Indian share of the War Effort would be, naturally, very considerable. Precise accounting and allocating of each would be proportionately difficult. And hence the necessity and utility of a working arrangement, to share the costs, even if no word be said to divide the benefits.

The agreement accordingly, began (a) by assuming a certain figure to be the normal Defence provision for India's own needs. This was fixed at the figure of the defence budget, effective,—in 1938-39, the last pre-war year, at Rs. 37.77 crores.

(b) To this basic figure certain additions were to be made on account of the rise in prices. This was also to be a charge upon the Indian Exchequer. In the first year, 1940-41, it was taken 'ad hoc' at .25 lakhs; but has since grown till, in the Accounts of 1942-43, it was Rs. 7.97 crores; and in the revised estimates for 1943-44, it is taken at Rs. 13.01 crores; and in the Budget of 1944-45, it was 15.04 crores, which was revised to 16.92 crores, and budgetted at 19.76 in 1945-46.

(c) Apart from this, it was felt, a very much larger figure would be necessary on account of India's own special measures, including additions to the armed forces of all kinds and their auxiliary services of all description. Supplies of food, clothing, munitions, and weapons as well and facilities needed for them on a very large scale would add another substantial figure. In the first War-Budget this item was taken at Rs. 3 crores, again an 'ad hoc' figure, but it has been rapidly growing as shown by the following figures:—

India's Own Defence Expenditure for Food etc.

(Figures in crores of Rs.)

1940-41	26.63
1941-42	53.88
1942-43	165.17
1943-44	307.99
1944-45	347.12
1945-46	321.86
1946-47	179.31
1947-48 Revised (net)	86.64
1948-49 Budget (net)	120.98

The last two items are Revised Estimates and Budget Estimates, respectively, as also those for 1945-46 and 1946-47, while the earlier figures represent the final accounts. This, it may be added, is, of course, exclusive of the Capital cost of such measures, which amounted, according to revised estimates of 1942-43, to over a hundred crores charged all on the Indian Exchequer. The total extra burden borne by India in the six years of the War was over Rs. 1,500 crores, over and above what India provided in the shape of goods and services to Britain for which she was paid (?) by I.O.U.s that have aggregated into the Sterling Balances once totalling nearly Rs. 1,700 crores.

(d) The last item was the maintenance cost,—or rather a share of it, of the Indian troops sent overseas to fight in the Empire's battles,—a fixed figure of Rs. 1 crore. The equity of this charge is not easy to understand.

So far as the land forces are concerned it was agreed that:—

(i) India would pay for the raising, training and equipping from Indian resources of all land forces raised in India, and for their maintenance as long as they stayed in the country and were available for the local defence of India. When they left for overseas, the cost to India of raising and training them, and also of equipping them, would be recovered from the British Government, who would assume all further liability for them.

(ii) All imported equipment and stores for such expansion measures of the land forces from whatever source (except vehicles, armoured or otherwise, from elsewhere than the United Kingdom) would be provided free by His Majesty's Government.

Apart from its general equity, this method of dividing the cost of this war had the advantage also of simplicity and administrative convenience. It involved the minimum of accounting, and ensured effective financial and administrative initiative. Authority for these measures was located in India.

(iii) War time outlay on the Royal Indian Navy consisted mainly of **war measures relating wholly to India's local naval defence**. No difficulty was, therefore, experienced in dealing with such naval joint measures as have been put into force in accordance with the principles of the Settlement.

(iv) Major **expansion of the Air Forces in India** raised a serious financial problem. This, like the expansion of land forces, was **a Joint war measure**. Although the role of the Air Force while located in India was to defend India, it was also allotted other duties when the removal of the immediate threat to India's security permitted. No definite decision was taken regarding an equitable and simple method, acceptable to both Governments, of allocating the very heavy expenditure in connection with the joint effort of the Air Force. Pending a definite solution an arbitrary amount, equivalent to half of the total estimated capital and recurring costs, was provisionally included in the Budget for 1942-43, and the balance was taken for the time being to a Suspense account.

This agreement made no provision on account of:—

(a) the non-effective charges, i.e. pensions and other allowances for the very much larger forces engaged on India's account. The Defence Estimates in the successive War Budgets have provisionally taken this item at Rs. 8.41 crores; but the extra was included in the still more complex problem of the Sterling Balances, settled in 1948.

(b) Similarly, *no arrangement was made for the disposal* and accounting of the surplus war stores. When the Sterling Balances problem, in which this was included, was eventually solved in 1948, the figure had risen according to British estimates to over Rs. 500 crores. It was finally settled by India taking them all over at Rs. 135 crores.

(c) The arrangement, likewise, takes no account of any alterations in the pay and other emoluments of British troops coming to India; nor of the corresponding or consequential increases in the pay and allowances of forces actually on the Indian establishment.

(d) The arrangement tends in practice to throw a disproportionately heavy burden upon India. And this, quite apart from her ethical or legal liability to be at all involved in the War.

Nature of the Problem of War Finance

The problem of War Finance it may be remarked, is not the same in India as in other countries. Those who have reached the peak of industrialisation have only to reorient their productive organisation to meet the needs of war. At the end of the war their task would be one of restoration and rehabilitation to regain their pre-war position. They have also some hopes of substantial benefit as the result of the war so as to compensate themselves in a measure for the losses suffered in the war.

India cannot expect to share in any such benefits—territorial gains or economic advantages. Her gain, if at all, would be in the improved sense of security, which all people may be expected to share because of the fall of the aggressor. That will not butter our bread; but it may help to reduce the burdens of unproductive military expenditure, which now takes a fat slice of our national income. The institution, however,, of the United Nations Organisation, with its Security Council, has not yet, three years after the War, put an end to the piling up of Defence Budgets all over the World; and in the case of India, even the Budget of 1948-49 provided three times the figure of Defence Expenditure of 1938-39.

As a consequence of the successful termination of the War on the side of the allies, India had hoped to achieve her national independence—Political independence has been achieved at the cost of national integrity in 1947, while emancipation from economic exploitation is only a change in complexion. Brown capitalists have taken the place of the white.

The problem of War Finance for India was not merely mobilising *the totality of available resources to win the war;* of co-ordinating the entire effort with that of the allies or associated on an equal footing. But while making the effort, India had to keep in view the programme of post-war intensification of her interrupted industrialisation. Her resources mobilised for the war must be so applied as not to impede, but rather to accelerate planned growth.

Besides restoring the pre-war norms, and making good the loss or damage occurring because of the War, we must so tune the forces of material progress we command as to add to and intensify our programme of industrial advance. With the achievement or acquisition of political independence, India would be free to shape her own immediate as well as long-term interests; and use her weapon of Public Finance actively and effectively to accomplish an all-round co-ordinated development of all her resources, so as to meet all her actual and

potential obligations in the fullest measure to her own people, to her neighbours and friends, as well as to those who would venture to try conclusions with her.

2. Change in India's Debt Position

The direct consequence of the heavy War Expenditure was the growth of India's Public Debt. Figures, as well as the component parts of this Debt, are given in an earlier part of this Volume dealing with Currency and Banking. There is, however, a noteworthy change brought about mainly by the War, viz. that almost all the Sterling Debt of the Government of India has been repatriated from the accumulating Credits due to India on account of goods and services supplied during the War to the British Government. This has been replaced by the corresponding Rupee Debt held in India. One large item of the 'drain' from India has ceased.

The policy of repatriating the Sterling Debt, and of ceasing to borrow abroad began much earlier than the War. During the Depression of the thirties when London had ceased to be the Central Money Market of the World; and particularly after a Congress Select Committee on **the Foreign Obligations of India** had shown the iniquity of many of the items entering into the Sterling Debt of the Government of India, the more far-sighted of the British Rulers in India decided to discontinue the programme of borrowing abroad, lest too close a scrutiny of the terms and conditions of the entire Sterling Debt may lead a strong nationalist Government in India questioning at the bar of an international tribunal the justice or legality of any item in the entire total. The wherewithal to pay all the then existing Sterling Debt, incurred mainly for Railways, Irrigation Works, as well as Wars, Famine relief and the like was not forthcoming until the War accumulated credits for India in London. Britain had to pay for the goods and services she needed from India. She had no means to pay—except these holdings of her nationals; and she used them to pay at least a part of the charges against her.

The economy, however, of such repatriation was open to question; for a Debt, carrying interest at 3% or 3½% at most, was paid off by means of funds which, had they been employed in Industry in India, would have fetched far, far larger profits. Political considerations may also be added to this reasoning, viz., that by liquidating this part of the Indian Government debt, we lost a bargaining counter which would have materially smoothed the final settlement of the complex problem of Sterling Balances.

3. General View of the War Budgets 1939-45

A general view of the War Budgets of the Government of India displays a very slow realisation of the nature and extent of the commitments they had entered into on account of the War. The last Budget before the War, viz. for 1939-40 had maintained a **status quo.** No additional taxes were imposed, while on the Defence Services Rs. 80 lakhs more were to be spent for mechanisation of certain units, erection of a modern munitions factory, postal defences and maintenance of six modern escort vessels. Heavy strain had just been borne by the Central Budget owing to the loss caused by the Separation of Burma, while the implementation of Provincial Autonomy, and the desire to start them on their new career with as fair a prospect as possible, led to additional burdens, which were all borne without the aid of additional taxation.

The original Budget for 1939-40 had anticipated a deficit because of the decline in the Customs revenue; but it was proposed to make good that fall by doubling the import duty on foreign cotton, estimated to yield, Rs. 55 lakhs, and so converting the deficit into a small surplus. The "Slab" system of Income Tax was also introduced in this Budget, and the Sugar Excise was modified; certain economies on the Defence side helped to keep down the expenditure to below the previous year's level.

With the outbreak of the War, and India's joining in the struggle, the ordinary Budget was thrown out of joint. Nevertheless the accounts of 1939-40 showed a surplus of Rs. 91 lakhs, which however, was more than absorbed by the anticipated deficit of Rs. 7.16 crores on account of the War. This deficit was to be met by:—

(a) an Excess Profits Tax, estimated to yield Rs. 3 crores;
(b) increase on the petrol duty by 2 as. per gallon, estimated to bring 1.40 crores; and
(c) increase in the Sugar Excise Duty from Rs. 2 to Rs. 3 accompanied by an equal duty on imported sugar, estimated to add another Rs. 1.90 crores.

A Supplementary Budget was necessitated in 1940-41 by rapidly mounting Defence Expenditure, and fall in customs due to shrinkage in trade. Defence charges had increased by at least Rs. 14½ crores and Civil expenditure by another Rs. 7 crores, while Revenue dropped by Rs. 3 crores. A 25 percent surcharge on all taxes on income, including Supertax and Corporation Tax; and an increase in postal rates, telegram and telephone charges were estimated to make good this deficit.

The next **Budget 1941-42** showed Expenditure rising by Rs. 15 crores, and revenue by Rs. 3 crores leaving a prospective deficit of Rs. 20 crores one-third of this was proposed to be met by fresh taxation and the remainder from Defence Loans. The previous year 1940-41 had shown a deficit of Rs. 8 crores due to an increased contribution from the railways and a surplus over from the year before. The Excess Profit Tax was raised from 50 per cent to 66.2|3 per cent, and the central surcharge on income-tax and super-tax from 25 per cent to 33.1|3 per cent. The match duty was doubled, import duty on artificial silk yarn and thread raised from 3 annas to 5 annas per pound, and an excise duty on pneumatic tyres and tubes levied.

Budget 1942-43.—But the following year showed a revenue deficit of Rs. 17 crores and a prospective deficit, on the prevailing basis of taxation, of Rs. 47 crores for the next year. The recoverable defence and supplies expenditure was estimated to exceed Rs. 400 crores in 1942-43. Once again the policy of covering the estimated deficit as to 2|3 by borrowing (Rs. 35 crores) and the balance by additional taxation (Rs. 12 crores) was followed. The new taxation included: (1) increase of surcharge on income-tax and Super-tax from 33½% to roughly 50%, (2) an all-round customs surcharge of 20% to be levied on existing import tariff except on raw cotton, petrol and salt; (3) increase in petrol tax by 25%, and (4) also in post and telegraph rates.

Budget 1943-44.—The total revenue for 1943-44 was estimated at Rs. 199.3 crores and the total expenditure at Rs. 259.59 crores, with a deficit of Rs. 60.29 crores. The deficit was to be made good by Rs. 20.1 crores of new taxation, and Rs. 40.19 crores by borrowing. Increases in income-tax, super-tax and corporation tax were estimated to yield Rs. 7 crores of new revenue, the budget proposals making a 66 per cent income-tax surcharge applicable uniformly over all levels of income.

Budget 1944-45.—The deficit rose still higher to 78.21 crores in 1944-45 which was met by ordinary taxation and compulsory deposit. Advance payment was demanded of tax on income from which tax was not deducted at source. The compulsory deposit of one-fifth of the excess profits tax was increased to 19|64 of the tax in order to immobilise the whole of the excess profits. This was expected to be in the neighbourhood of Rs. 75 crores. The scale of income-tax was raised to bring in an additional revenue of Rs. 8½ crores, and increased surcharge on tobacco and spirits under customs duties

was expected to yield another crore. Excise Duty on tobacco was increased to yield Rs. 10 crores and Rs. 4 crores by bringing betelnuts, coffee and tea under the Central Excise Tariff. The defence expenditure for 1944-45 was estimated to amount to Rs. 276.61 crores under Revenue Budget and Rs. 24.60 crores under Capital Budget.

Budget 1945-46.—The accounts for 1943-44 showed the deficit to be Rs. 189.79 crores as against the revised estimate of deficit of Rs. 92.43 crores. This was due to an excess of Rs. 96 crores on Defence account. It was hoped to get an additional revenue of Rs. 8.60 crores by raising the tobacco duty, by increasing the rate for postal parcels from annas 6 for the first 40 tolas and annas 4 for every 40 tolas thereafter to a uniform annas 6 for every 40 tolas, by raising the surcharge on telephone rentals from one-third to one-half and that on trunk call rentals from one-third to one-half, and that on trunk call fees from 20 to 40, per cent, and by increasing the surcharge on ordinary and express telegrams by one anna and two annas respectively. Thus the prospective deficit would be reduced to Rs. 155.29 crores to be met by borrowing. For the first time this Budget differentiated, as regards Income-tax rates between earned and unearned incomes, charging higher rates on the latter.

Budget 1946-47

The first peace-time budget was faced with the possibility of a steep fall in wartime expenditure, income levels, and the continued rise in inflation. The Budget estimated revenue at Rs. 311.65 crores and expenditure at Rs. 355.71 crores with a deficit of Rs. 44.06 crores, after allowing for new taxation and the transfer to revenue of Rs. 26.10 crores the balance in the two War Risks Insurance Funds.

The new taxation proposals included:—

(1) abolition of the Excess Profits Tax after the 31st March 1946;

(2) grant of special initial depreciation allowance of 10 per cent. on new buildings, and 20 per cent. on new plant and machinery and for expenditure on scientific research, for purposes of Income Tax;

(3) relief from Customs duty on raw materials plant and machinery imported for industry;

(4) reduction of 1¾ annas in the total rate of Super Tax and Income Tax;

Financial Position of the Provinces and the Centre from 1937-38 to 1946-47

(a) Provinces

(In lakhs of Rupees)

Provinces	Provincial Revenue	Devolution Grants from the Centre including Dev. Grants	Total Revenue	Total Revenue Expenditure	Cumulative Deficit (—) Surplus (+)	Balances in Reserve Funds on 31st March 1947
Madras	2,63,27	24.12	2,87,39	2.84.22	+3,17	29,18
Bombay	1,92,52	26,51	2,19,03	2.06,39	+12,54	17,07
Bengal	1,65.35*	69,92	2,35 27	2.51.13*	—15,36	25
United Provs.	1.79.33	26,77	2.06,10	2.04,99	+1 11	17.31
Punjab	1,84,12	11.51	1.95.63	1,60,46	+35,17	6.79
Bihar	75.06	15.10	90 16	81,81	+8.35	7,78
C. P. & Berar	63.61	7,69	71.30	70,66	+64	8,14
Assam	35,54	7.86	43,43	42.89	+54	1,02
N. W. F. P.	11,94	11.55	23,49	22,95	+54	15
Orissa	17,71	7·93	25.64	25.11	+53	10
Sind	55,19	10.27†	65,46	60,04	+5.42	8.14
	12,43,64	2,19,26	14,62.90	14.10,35	+51.05	95,93

*Subsidy of 3,00 in 1943-44 taken by Bengal as reduction of Expenditure on Famine. Hence Revenue and Expenditure both have been increased by 3,00.

†The subvention was capitalised on 1st April, 1944 and the value set off against the Lloyd Barrage Debt.

Source:—Report of the Expert Committee (Constituent Assembly) on the Financial Provisions of Union Constitution, 1948. Page 26.

(b) Central Government (1937-38 to 1946-47)

(In lakhs of Rupees)

Year		Revenue	Expenditure			Deficit (—) Surplus (+)
			Civil	Defence	Total	
1937-38	..	86,61	39.39	47.22	86.61	..
1938-39	..	84.52	38.97	46.18	85,15	—63
1939-40	..	94.57	45.03	49,54	94.57	..
1940-41	..	1,07,65	40,57	73,61	1,14,18	—6,53
1941-42	..	1,34,57	43,33	1,03,93	1,47,26	—12,69
1942-43	..	1,77,12	74,28	2,14,62	2,88,90	—1,11,78
1943-44	..	2,49.95	81,44	3.58,40	4,39.84	—1,89,89
1944-45	..	3.35,71	1,00,77	3,95,49	4.96.26	—1,60,55
1945-46	..	3.31.18	1.24.38	3,60,23	4,84,61	—1,23,43
1946-47	(Revised Estimate)	3.36.19	1.43,36	2,38.11	3,81.47	—45,28
Total	..	19.68.07	7,31,52	18,87,33	26.18,85	—6,50,78

Revised Estimates have generally been taken for 1946-47.

Source:—Report of the Expert Committee (Constituent Assembly) on the Financial Provisions of Union Constitution. 1948. p. 26.

(5) exemption from Income Tax for two years of residential buildings and initial depreciation of 15% for business premises;

(6) reduction of tax rate income of Rs. 3,500—Rs. 5,000 by 3 pies and on those between Rs. 5,000—Rs.7,500;

(7) the raising of the earned income allowance from one-tenth of the earned income (subject to a maximum of Rs. 2,000) to one-fifth (subject to a maximum of Rs. 4,000);

(8) similar differentiation in Super-Tax rates for earned incomes;

(9) reduction by 18 pies per gallon of the duty on kerosene oil; and on motor spirit by 3 annas per gallon;

(10) reduction in the excise duty on betelnuts by one anna per lb. and 6 pies in customs duty on betelnuts;

(11) reduction in the duty on cinematographs film (not exposed) by 3 pies per linear foot;

(12) reduction in the price of a match-box by 3 pies and a similar reduction in the price of a post-card.

Reductions in expenditure arising from the cuts by the Legislative Assembly amounted to Rs. 93.34 lakhs on revenue account, and Rs. 3.46 crores on capital account. The deficit, originally estimated, was increased to Rs. 48.25 crores, with revenue at Rs. 341.87 crores and expenditure at Rs. 390.12 crores.

The Budget was further remarkable by the proposal of an Industrial Finance Corporation to provide medium and long term finance to industrial enterprise in India, and planned investment both public and private, to secure the fullest and most advantageous utilisation of the country's economic resources.

An Interim Tariff Board was appointed, and a plan was under preparation to establish an Industrial Finance Corporation, which was finally adopted by a special Act passed in 1948.

The Industrial Research Planning Committee has recommended the creation of a Central Research Organisation to be called the National Research Council. Recommendations have also been made for the immediate adoption by the Council of a five-year plan which included the establishment of a Na-

tional Chemical laboratory, a National Physical Laboratory, and a network of laboratories in all Provinces and major States. These have also begun to be implemented in 1947-48.

A housing scheme for industrial workers was put forward with a construction of two million houses in 10 years, estimated to cost Rs. 40 crores within the first 2 years. The scheme provided for Central subsidies upto 12½% to local bodies and industrial and other employers, if the provincial government concerned made an equivalent grant. A unified scheme of social security, covering health insurance, maternity benefits, and compensation for accidents was forwarded to Provincial Governments covering all perennial factories, designed to remove some of the defects in the present working of the Workmen's Compensation Act, and the Maternity Benefits Act. This, too, has been enacted in 1948.

Regarding the financial implications of the post-war planning the provincial five-year plans are estimated to involve an expenditure of Rs. 900 crores, a part of which might extend into the second five-year period. The Central plans in respect of railways, roads, civil aviation development were estimated to cost still more. To expedite carrying out of these Plans, the Budget promised the Central Government would assist the Provincial Governments with funds for approved schemes, particularly those which may provide a high proportion of employment and calculated to increase the national income. A lump sum provision of Rs. 35 crores was made in the budget for advance payments, and of Rs. 15 crores for loans to provinces for productive development works.

The Central Government's own expenditure of this kind was estimated at Rs. 49 crores of which Rs. 22 crores were in respect of railways.

Estate Duty

With a view to assisting Provincial Governments in implementing their post-war plans, a bill to levy an estate duty on non-agricultural property was introduced in the Central Assembly on March 21, 1946. A duty was to be charged at graduated rates according to the principal value of all property passing on the death of an owner whether by will or any settlement made by others. Immovable and movable property not exceeding Rs. 1 lakh in value and property, situated outside British India, were exempted. This duty being on non-agricultural property, the Provinces were free to levy a similar duty in respect of agricultural property.

4. Sterling Balances

The accumulation of enormous sums in the so-called Sterling Balances was directly the outcome of the War Expenditure by the Government of India on behalf of the British Government, which was said to be recoverable from the latter, when the War had ended. Though some kind of a settlement has been arrived at, by setting of considerable amounts against surplus stores, installations and equipment, as well as Pensions to British personnel retired from the Indian Service, the bulk of these balances still remains to be recovered from that Government. The problem, however, has been considered in greater detail in another Volume in this Series, and so need not be rediscussed at this stage.

5. Effects of Partition

The Budget of 1947-48 presented in March, 1947, was conspicuous for its sharp increases in tax-rates, its evident anxiety to rope in as much as possible of the War Wealth which had escaped taxation, and its attempt at introducing such new varieties of direct taxation as the Capital Gains Tax or the Estate Duty. As the then Finance Minister was a Muslim, and communal tension was running very high, the dominating features of the Budget were suspected of being inspired by Partisan considerations rather than by intrinsic merit of each proposal. Considerable agitation followed, on account of which the Finance Minister was compelled to make substantial concessions to the affected vociferous classes; but the advance made was not altogether sacrificed. Partition of the country following soon after, however, many of the constructive lines of development, chalked out in the Budget 1946-47, were either impossible to follow up, or were taken up in a half-hearted manner for fear that the reaction of the Partition could not be fully judged.

When the principle of Partition had become accepted, but before actual division came to be an accomplished fact, a series of Conferences was held between the two Dominions to make a fair division of Assets and Liabilities. This was effected eventually by an agreement between the two Dominions, arrived at on general principles as well as in many cases in detail; and where agreement could not be reached, recourse was had, as agreed upon in advance, to arbitration. The implementation of these agreements in the several departments took time. The basic idea was that the Indian Government should take responsibility for the total Public Debt, and the Pakistan Government agreed to make a contri-

bution *pro-rata* for the Debt which fell to its share. The same principle applied to the Pensions.

On the question of the Sterling Balances also a similar procedure was adopted. On all the leading issues involved the two Dominions first made an agreement among themselves, and presented a more or less united front on those principles to the British Government. Considering the magnitude and complexity of the issues involved, considering the value and volume of item affected, and looking at the height of communal passions as well as the shortness of the time given, the arrangement must be pronounced to have displayed a degree of statesmanship and a desire for mutual accommodation, which might have been perhaps more advantageously employed in removing communal tension till it culminated in a complete Partition of the country, an act of vivisection as Mahatma Gandhi had described it.

A Supplementary Budget was presented in August 1947 for the remaining 7½ months of the fiscal year which recognised this sad fact of Partition, but made no very radical departure in the basic framework of the Indian Financial System. The new and complex problems created by the wholesale dislocation of millions of people from their ancestral homes, and their re-settlement in new lands, new trades, or occupations; another series of equally difficult problems created by the accession, admission or assimilation of hundreds of Indian States into the Indian Union, and by such developments as the Kashmir venture, shortage of food supply, decline in production, the rise in prices, the removal of controls on essential commodities and services, kept the financial position of the country in unrelieved gloom.

The latest Budget of 1948-49 had the same outstanding features to deal with. A beginning for restoring normal conditions of peaceful progress was made in an *ad hoc* Economy Committee to consider the Expenditure side of the national Budget. It was, however, apprehended in many quarters that this problem would not be considered by such a body so much from the standpoint of scientific economy in Public Finance, but rather from the standpoint of arbitrary retrenchment, unco-ordinated and unrelated to the long-range demands of National Economy. The Taxation Committee, promised in the Raisman Budget of 1946-47 has yet to come. Meanwhile considerable new enterprise is being undertaken, either directly by the State, as in the case of the several multi-purpose River Training projects, or by the State in partnership with private enterprise, as in the case of the Overseas

Shipping and Air Transport Services; or some combination of both, which is expected to develop rapidly public utilities and social services of a momentous character in the economic life of the country.

Rise in prices was, if anything, steeper after that Budget than ever before. Neither the settlement of the Sterling Balances issue, nor the establishment of specific Committees for securing to the Exchequer the tax payments which had been evaded in the previous years, nor the progress made in the resettlement of Refugees sufficed to moderate the sharp spiral of prices.

At the present time, therefore, India's Budget continues to be in the grooves made for it during the British regime. Practically all the outstanding features evolved then have been continued. Public Finance as an active agent in Planning national development has yet to be reorganised; and the reconditioning of the resources and their co-ordination with the new duties or functions the State may assume under its new inspiration awaits the introduction of planned economy that has been promised but has not yet been made.

6. Redistribution of Financial Resources and Obligations Between the Centre and the Units*

Present Constitutional Position.

Under the Government of India Act, 1935, the taxing powers of the Central and Provincial Legislature are entirely separate. Provinces retain all the net proceeds of all taxes levied by them, while the Central Government shares or distributes among the units the net proceeds of some of the taxes levied by it.

(1) Federal Estate and Succession duties, (2) Federal Stamp duties, (3) Terminal Taxes on goods and passengers carried by Railway or Air, (4) Taxes on Railway fares and freights, are taxes which, if levied, would have to be given away to the Units.

The Centre can levy a surcharge on those taxes entirely *for its own purpose. None of these taxes has, in fact, been* levied, except that the Federal Stamp duties, which are levied under the old laws, and the duties collected and retained by the Provinces.

*Constituent Assembly Report of the Expert Committee on the Financial Provisions of Union Constitution.

Federal taxes, the net proceeds of which are shared with the Provinces, fall into two groups:—

(1) Taxes, the net proceeds of which must be shared are: Income-Tax and Jute Export Duty;

(2) Taxes, the net proceeds of which may be shared if the Union Legislation so requires are: Central Excise, including duty on salt, and export duties except on jute and jute products. The Central Legislature has levied certain taxes under these heads, but has not provided for giving any share to the Provinces.

Besides these the Act provides, for fixed grants-in-aid to some Provinces to make their autonomy real. There is also a general provision for giving grants to Provinces at the discretion of the Central Government either for general or specific purposes.

Review of Finances of Provinces and the Centre.

During the war, all Provinces, except Bengal, had surplus budgets. Revenue increased several times due to the war and the levying of a number of new taxes and increasing the rates of existing ones by the Provinces. At the same time all development work was stopped, which limited expenditure. The result is given in the Introduction.

The Provinces are now faced with a heavy programme of expenditure without any corresponding increase in revenue. Apart from voluntary sacrifice of Excise Revenue, as explained in the Introduction, Land Revenue, both in the permanently and temporarily settled Provinces, is likely to decline, Stamps and Registration Fees are unlikely to increase much; Forest Revenue will dwindle because of large falling during the War. Sales Tax, Electricity Tax and Entertainment tax may not fall much below the war-time peak; but by themselves they cannot make up the gap likely to be caused by the above factors.

Provincial Governments have thus practically exhausted their exclusive field of taxation. At the same time, they have to share it with Local Bodies, which are also expanding their activities. A substantial development of new revenue resources is thus inevitable, if essential and overdue programmes of Social Service and Public Utilities are undertaken.

No great assistance can be expected from the Centre, which has been having deficit budgets for a number of years. Due to the serious food shortage, the refugee problem, Kashmir

expedition, and the complex consequences of the Partition of th country, deficit continues.

Essentially, however, and taking a long-term view the financial position of the Union is not desperate, as almost all these problems are temporary. When they are solved, the budgetary position of the Centre would improve. Administration and collection of Central Taxes, like those on income, leave much room for improvement. Not only should it be possible to collect larger sums on account of those taxes in future, but also to secure the large sums that are believed to have been withheld from the tax collector. If necessary appropriate legislation may be passed for this purpose. Under Customs and Excise there may not be much increase, nor in Railway contributions.

On the other hand, expenditure on Defence and Foreign Affairs will very likely grow further still; while there is little prospect of any reduction in the Debt Service. There may be some scope for reduction in the existing Civil Expenditure. But here, too, the expansion in Developmental activities under a National Plan promises very substantial increase, even though many of those departments are directly the responsibility of units. The problem, therefore, is how to improve existing sources and devise new ones, which would provide adequate resources for carrying out all items in an over-all National Plan of economic and cultural development for the country as a whole and for every part of it.

An aspect of the problem, which is more of a constitutional than of a financial character, needs to be emphasised at this point. This is not a question of merely transferring revenues from the Centre to the Units, or increasing Grants and Subventions from the Centre to enable the Provinces to carry out their part or items of the National Plan. Such Grants and Subventions are at the best mere doles, which may help to keep in line all the Units and allow the Plan to be given effect to on a co-ordinated and simultaneous level. But at the same time they would irresistibly tend to undermine the Unit's Autonomy by introducing or imposing stipulations or conditions on which only the Grants are made or Subventions given. It is, therefore, for those who are charged with the responsibility of making the country's Constitution to determine how far it is desirable to increase the Unit's own resources and make them correspond as closely as possible to the obligations imposed upon it in the new set-up in the country's planned economy, or whether they are to be for ever dependent on the Union Government for carrying out such items or sectors of the National Plan as come directly under their jurisdiction.

Claims of Provinces.

Every Province is eager to carry out its programmes of social service and economic development at the earliest opportunity. But for this purpose, its own resources existing as well as potential, are limited.

The Units are divided amongst themselves as regards the apportionment of taxes which are to be shared, e.g. Income Tax. Bombay and West Bengal support collection or residence as the basis for distribution; U.P. that of population; Bihar, the combined basis of population and place of accrual; Orissa and Assam want weightage for their backwardness. East Punjab wants her deficit of Rs. 3 crores somehow to be met. In the case of excise taxes, the bases suggested for apportionment are production, collection, consumption, and population. Assam again demands weightage for her low level of revenue, and special treatment of Excise collected on wasting assets, like patroleum produced there. She also wants a share of the export duty on tea.

General Observations.

The Experts Committee appointed by the Constituent Assembly to advise on this problem take their task to consist in a proper distribution of the total available resources among the Union and Unit Governments adequate to the functions imposed on each; so, however, that the arrangements are not only equitable in themselves, and in the interests of the country as a whole, but are also administratively feasible. At the same time, there must not be too violent a departure from the status quo. The weaker or more backward Units must be brought up into line, and the progress of all assured on as even a course as possible.

The basic functions of a Federal Government are Defence, Foreign Affairs, and National Debt, Service,—all unproductive expenditure. "Communications". would ordinarily pay for itself and may, if properly developed, along with the Transport Service, yield a substantial and progressive surplus. Co-ordination of planned development in research and higher technical education may require increasing aid from the Centre if not its own direct expenditure steadily expanding in volume and variety. The task of active development of the country's aggregate resources cannot be engineered on a planned basis except with Central Aid. The needs of the Provinces are, almost unlimited, particularly in relation to Welfare work and Development programme. If these services and increase of the country's new wealth are to be properly planned and exe-

cuted, it is imperative that Units should have adequate resources of their own, without depending on the variable munificence or affluence of the Centre. The Provinces must, therefore, have as many independent sources of revenue as possible. It is not practicable at the same time to augment materially their revenues by adding more subjects to the Provincial List, without upsetting the equilibrium of the Centre. Divided resources are thus unavoidable. A few of the most productive and elastic sources of income may be divided, the shares of the Centre and the Provinces in them being adjusted automatically without friction or mutual interference.

Lists of taxes for the Centre and the Units

No great change is recommended in the List of taxes in the Federal Legislative List except that a higher limit Rs. 250 is recommended for taxes on professions, trades, callings and employments. Stamp duty on the transfer of shares and debentures are proposed to be transferred to the Federal list but the duties will accrue to the Provinces, though in view of the far-reaching effects on public credit and finance of Stock Exchange transactions, the Expert Committee thought the Centre should legislate for the regulation of such transactions; and the taxes arising out of such regulation should be retained by the Centre unless they are merely duties on transfers of shares and debentures, when the units should have the proceeds. A few minor changes were also suggested in the Provincial List; but they do not affect the main design. The Expert Committee recommended no new sources of Revenue, and were unwilling to recommend public Lotteries on moral rather than material grounds.

For the Central Government, the Experts Committee recommended the levying, collection and retention of the proceeds of all Federal Taxes, Customs Duties, including export duties; Taxes on capital value of assets and on the capital of Companies, Taxes on Railway fares and freights. If that involved any loss to the Provinces, they recommended Specific grants for a period of 10 years or till the export duties on jute and jute products were abolished, whichever was earlier.

The Expert Committee desired the tax on agricultural incomes to be also Centralised after a number of years if the Provincial Governments concerned agreed to that course. For the rest they suggested that the net proceeds attributable to Chief Commissioner's Provinces should be retained wholly by the Centre; but the proceeds of the income tax on incomes derived from Federal revenues should be shared. The Provinces, they urged, should get not less than 60 per cent. of the

net proceeds of all income-tax, including the net proceeds of Corporation Tax, and taxes on federal emoluments. The Centre should have, however, the right to levy a surcharge for its own use, but only in an emergency.*

They also suggested that 50% of the net proceeds of the Central Excise on Tobacco, which does not receive any fiscal protection should be allowed to the Provinces. They, however, did not accept the suggestion that the Union should be confined only to specific excises and all the rest be left to the Units. They do not disturb Sales or Purchases Tax which is now enjoyed by Provinces. It has great potentiality if it is levied at a uniform rate all over the Country and collected Centrally; but the proceeds assigned to the units.

Estate and Succession Duties cannot be administered satisfactorily except by the income-tax staff. If the Centre is to part with a substantial share of income taxes, and also a part of certain Central excises, it should get a share of the Estate and Succession duties. The Experts accordingly recommended that not more than 40% of the net proceeds of such duties should be retained by the Centre.

Terminal Taxes on goods or passengers carried by railway or air are suitable only for purely local purposes, i.e for the benefit of municipalities, pilgrim funds, etc. but they can be conveniently levied and collected only by the Centre. No change was consequently recommended.

Grants-in-Aid and Subventions.

Assam and Orissa now get fixed Subventions of Rs. 30 and 40 lakhs per annum, respectively. The increase in the Provincial share of income-tax and the transfer of a share in the excise on tobacco recommended by the Experts would increase the Provincial revenues substantially. If in spite of that, any Province needs a Subvention, the Expert Commitee have suggested specific amounts for particular Provinces and also a fuller investigation by a special Commission of the entire Problem.

The Experts recognised that during the developmental stages of the country it would be necessary for the Centre to make specific grants to the Provinces from time to time. In India, on the other hand, as for example in the U.S.A., the

*At the last conference of the Finance Ministers, from the various Provinces, strong difference of opinion manifested itself as regards the division of the income-tax and the ways and means to be adopted for liquidating Zamindars.

difference in the levels is very wide, and the number of units larger when acceding States come into the picture. In such a background 'averages' would be mere mathematical concepts totally unrelated to actual facts. On the other hand, even in a Federation of autonomous units, there is a great deal to be said for helping the less prosperous units to come up to the level of the more prosperous ones. As in all such matters, we must take a realistic decision with reference to the conditions in our country. While we do not recommend the adoption in this country of the Australian system, we have no doubt that the Centre, while distributing such specific-purpose grants should bear in mind the varying circumstances in the different Provinces, and try and make the conditions in the several units as nearly approximate as possible.

Special assistance is recommended to Assam in respect of expenditure for promoting the welfare of scheduled tribes in the Province. Similar aid is also demanded on behalf of Orissa to develop her backward areas. The Experts having no data, could not assess the measure of assistance, if any, required by this Province. They consequently expressed the view that if the Central Government, after a due examination of the question in all its aspects, decide that special assistance is necessary, it should be provided on an adequate scale.

Taxes on Agricultural Income and Property.

Taxation of agricultural income, now allowed to the Provinces, while all other income is taxed by the Centre, stands in the way of a theoretically sound income-tax system. In view of the ease with which the origin of agricultural income can be traced, it could be arranged that this tax, even though levied and collected by the Centre, as part of an integrated system of income-taxes, should be handed back to the Provinces. It could be further arranged that till the Centre levies such a tax, the Provinces already levying it might continue to do so. The existing arrangement, on the other hand has the political merit of keeping together in one place both benefit and responsibility. Under the arrangements recommended the Provinces will have full control over but few important heads of revenue. A few provinces have, in fact, levied a tax on agricultural incomes since some years; and they can administer this particular tax with greater facility than the Centre. For the moment, therefore, the Expefts recommended status quo. In view, considering, however, the importance of the matter, they suggested that the Provinces should be consulted at once; and if a majority, including those now levying the tax, agree,

this tax and a cognate one on Agricultural Property may be omitted from the Provincial List of subjects.

Division of proceeds of Revenue between Provinces.

The Experts discussed at some length the various bases of distributing between Provinces as regards the share of proceeds from taxes on income, and came to the conclusion that no single basis would lead to equitable results. Place of Origin, the residence of Owner, the place of Collection etc., were suggested. But in complex industrial and commercial structure of modern times, where a single point of control regulates a vast net-work of transactions and more than one of these stages relate to the same tax-payer, the assignment of a share of profits to each stage can only be empirical or arbitrary.

Pending enquiry by the Finance Commission which the Experts recommended should be set up at once, the Experts accepted the basis of collection as well as population, making at the same time the necessary provision for adjustment on the basis of need, and recommended the Provincial share of 60% of the net proceeds should be distributed among the Units as follows:—

20% on the basis of population at the last Census.
35% on the basis of collection.
5% to bring about as much equilibrium as possible.
——
60

As for the Excise Duty on tobacco the most equitable method of distribution is on estimated consumption.

Estate and Succession Taxes have not so far been levied; but a Bill on the subject is now before the Central Legislature. The manner of distribution of the net proceeds of these taxes among Provinces will have to be first determined before such taxes can be imposed. No data about their incidence are available today; and so if and when the taxes are levied, they will have to start with some *a priori* basis for estimate as well as apportionment among Provinces. The Experts therefore recommended for the time being the basis of the location of the real property taxed to apportion and distribute the proceeds. Of the balance—

75% should be on the basis of the residence of the deceased; and 25% on the basis of the population of the Province.

The administration and distribution of these taxes would ordinarily fall on the Central Board of Revenue, it would be necessary to empower an appropriate authority to adjudicate in the case of disputes between Provinces as to the residence of individuals.

Effect of the Proposals.

The net effect of these recommendations is, on the present basis of revenue that the Centre would have to transfer to the Provinces something like Rs. 30 crores annually. A part of this loss will be made good to the Centre by the Estate and Succession Duties, of which it will retain 40%.

The Experts also advised a periodical review so that the method of apportionment can be adapted to changing conditions from time to time on the basis of experience.

Needless to add that to the extent that the Centre transfers its resources to the Provinces, whether new taxes or increased rates on existing sources, its ability to make specific grants to the Provinces must be correspondingly reduced.

Finance Commission.

The initial basis of apportionment among Provinces, suggested by the Experts is, of course, not permanent. They accordingly recommended the immediate appointment of a Finance Commission, a Tribunal of five members including a Chairman of long judicial experience, which need not be a permanent body working whole time, but an ad hoc creation appointed by the President of the Union in his discretion, so as to exclude any chance of a bias in the members.

Pending the setting up of the Finance Commission, the Central Government should take steps in consultation with the Provinces, to collect, compile and maintain statistical information on certain basic matters e.g. the value, volume, and distribution of production, the distribution of income, the incidence of taxes, both Central and Provincial, the consumption of important taxed or taxable commodities, etc.

When set up, this Commission should be entrusted with the following functions:—

(a) To allocate between the Provinces, the respective shares of the proceeds of taxes that have to be divided between them;

(b) To consider applications for grants-in-aid from Provinces and report thereon;

(c) To consider and report on any other matter referred to it by the President;

(d) Make recommendations on any connected subject. In making such recommendations, the Commission must consider all relevant matters, including the state of finances of the Centre. If these recommendations do not involve any change in the Constitution, they would, when accepted by the President, be given effect to by his Order, while those involving a change in the Constitution, if accepted by the President, would be dealt with like any other proposed amendment to the Constitution.

Residuary Powers of Taxation

Under the Draft Constitution, residuary powers of taxation are to be vested in the Centre, so far as the Provinces are concerned, while in respect of the States that will be in the States themselves. To avoid any abuse of this power, all possible taxes that could be listed may be given to the Provinces. But that is obviously impracticable.

Exemption of Provincial Governments From Taxation.

Under the existing constitution profits of state trading by a Province are taxable only if the trade was carried on outside the Province. Trade here includes industrial enterprise also. With the present tendency towards nationalisation of profitable public utilities, like road transport, the exemption of such Provincial enterprise from taxation would cost the Centre sufficiently to necessitate removal of such exemption, or devise some way for the Centre to share in the profits.

The Experts felt that if nationalisation of industries takes place rapidly, the whole question would have to be reviewed de novo, as by that the entire structure of the tax system of the country would be completely changed. It must be remembered, however, that in proportion as the Provincial Revenues expand because of these profits, the need for Grants or Subventions from the Centre would diminish. In fact it is the view of the Interim Report that the course of financial progress would be most satisfactory which substitutes more and more the profits of enterprise for the burdens of taxation.

On trading operations of the Central Government, the Experts recommended exemption from income-tax. This sound principle has been recently abrogated in the case of the

Industrial Finance Corporation. The experts themselves also thought that if the trading is carried on by a separate juristic person, the profits of such enterprise must be taxable.

Trading operations of Units, the Experts further suggested, whether carried on within or without their borders, should be taxable, the tax or contribution in lieu thereof being treated as ordinary income-tax revenue going into the divisible pool.

Quasi-trading operations of Provincial Governments incidental to the ordinary functions of Government, e.g sale of timber by the forest department, or of jail products should not be taxable.

Emergency Provisions.

As for times of emergency, such as war or large scale internal disorder, the Experts suggested, the Constitution should specially authorise the President to suspend or vary the financial provisions in such manner as he thinks would meet the circumstances.

In regard to Borrowing Powers, at present the Provinces can borrow in the open market in India, except when they are indebted to the Centre. This right gives then a sense of financial responsibility. But it is necessary to ensure that borrowing Governments do not, by their competition, upset the capital market. Under existing arrangements the Reserve Bank provides this check, as it advises all the Governments. With a growing programme of economic development all over the country, Borrowing will have to be resorted to on our increasing scale, when expert machinery may be necessary to fix the order of priority in borrowing for the different Governments. A Minister's Conference would help, without prejudicing the responsibility for borrowing policy, to avoid unnecessary competition.

The Experts advised against a Provincial or Government borrowing in a foreign market except with the consent of the Federal Government, and under such conditions as the Federal Government may think fit to impose.

7. Reaction on Indian Finance by the Accession, Admission, or Assimilation of States.

This is the most difficult, perhaps, of the problems facing not only the Finance Minister, but also the Constitution makers. The difficulty arises as much from the lack of statistical data as from the complications of the problem itself, as

conditions differ widely between the Provinces and the States and also from State to State, which makes it difficult to apply a uniform formula.

A Committee of the Constituent Assembly, concerned with defining Powers of the Union Government, recommended that uniformity of taxation throughout the Units may, for an agreed period of not more than 15 years after the establishment of the Union be kept in abeyance and the incidences, levy, realisation and apportionment of the above taxes in the State Units should be subjected to agreements between them and the Union Government.

If the Union of India is really to secure for the States a similar standards of economic development to that in the Provinces, fiscal arrangements and administrative efficiency, the readjustment and redistribution of resources would have to be very thorough going.

As a first step to achieve this, the Committee of Experts appointed by the Constituent Assembly recommended, each State should have a proper Budget prepared as soon as possible, and maintain proper accounts regularly audited.

They were quite clear that the States should gradually develop all the taxes which the Provinces are allowed and give up reliance on taxes reserved for the Federation. This process, however, would necessarily take some time; and in the meanwhile it will be necessary to have transitional arrangements. The most important of the Union revenues the States enjoy are Land Customs. Immediate abolition of that source would be inadvisable as it would lead to a serious dislocation in the States' finance. On a long view, however, in the interest of the States themselves, these duties should be replaced by other taxes, e.g. sales and turn over taxes. The time within which this should be accomplished is fixed at 10 years. In the meantime, no State should:—

(1) hereafter levy land customs on a commodity on which there is no such duty now, nor

(2) increase the rate on any commodity, after a fixed date; and

(3) a State levying land customs should grant refunds on re-exports.

Maritime customs should be uniform all through the Union. The Union Government should alone administer them. If this arrangement results in the loss to any State of the

revenue now enjoyed by it, it is only fair that the State should be compensated for the loss pending determination of the appropriate compensation in each case by a States Commission.

The Experts recommended that the Union Government may levy Central Excises in all the States. But those States now enjoy the benefit of a part or the whole of these revenues raised in their areas, should receive grants in lieu of these benefits equal to the average revenue during the last three years.

The Indian Income Tax Act, with necessary modification should be applied to all the Federating States. The net proceeds of the tax proceeds attributed to the States may be credited to a States Income Tax Pool, and such portion, not less than 75 per cent. of the net proceeds attributable to each State, may be paid back to the States.

The need for a uniform system of income-tax in the Provinces and States has now become urgent, not only because of the facilities afforded for evasion and avoidance of this Tax by lower rates or no tax at all in the States but also because of the diversion of industries artificially by the incentive of lower taxation.

The experts did not attach much weight to the argument that the States are, as a whole, industrially backward, and so they cannot stand the same high rates of Income-tax as the Provinces.

They recommended, however, the establishment of a States Commission to advise on the financial systems and suggested methods by means of which the States could develop their resources, and fall into line with the Provinces as quickly as possible; to examine in detail the privileges, immunities and liabilities of each State, and recommended a suitable basis of compensation for the extinction of such rights and liabilities.

The States which come into the above arrangements would pay their contribution for Defence and other Central services through their share of the net proceeds of Central taxes retained by the Centre, and nothing more should be expected from them. On the other hand, the States which accede but do not come into the above arrangements should pay a contribution to the Centre, as determined by the States Commission. Though the arrangements recommended by the Experts was of a general nature, they also suggested grouping together a number of smaller States in units of their own as condition precedent to their being brought into any reasonable financial pattern.

8. Post-War Planning.

The Budget of 1946-47 was also remarkable in that that Government announced their policies and plans of post-war development. In a statement issued on April 21, 1945, they declared the fundamental objectives in regards to the country's industrial development which were:—

(1) to increase the national wealth by the maximum exploitation of the country's resources, the new wealth being distributed in a socially equitable manner;
(2) to make the country better prepared for defence, and
(3) to promote a high and stable level of employment.

To attain these objectives, it was proposed:—

(1) to transfer from provincial jurisdiction to the Centre 20 industries,
(2) to nationalise basic industries of national importance,
(3) to assist industries by means of making loans, or subscribing a part of the capital, or guaranteeing a minimum dividend; and buying as far as possible, Indian products in preference to others.

Reference has been made, earlier in the Introduction to this Volume as well as in this Summary, of the gradual realisation by the Indian Authorities of the need for planned development of all resources and potentialities of the country. The Budget of 1946-47, the first peace Budget after six years of war dislocation, had devoted considerable space to outline the policy of the then Government in that regard. A definite policy was formulated in 1944, as explained above, with a separate Department of Government for Planning and Development. As this matter has already been considered while outlining the Budget proposals of 1946-47, and as the entire Series deals with planned development of the country, in every item and aspect of its material and cultural life, no further observations are necessary now on the subject.

9. Growth of Statutory Corporations.

With the coming into power of the National Government a new departure in policy has been made by setting up more than one specific Statutory Corporations to carry out particular objectives. These Corporations affect Public Finance at more than one angle, and are a recent growth rapidly becoming popular. They are not all State-owned in their entirety. But

even where they are associated with private enterprise, or have been formed by private capital, under the authority of the Statute, they constitute a new departure a step forward in gradual elimination of private enterprise dominated by the profit motive. However owned, these corporations are not worked, primarily, for profit or a commercial surplus but for service and help to the community. If there is a profit, it comes wholly or in stipulated proportions to the State. The attempt, therefore, made in one of the latest enactments to charge Income Tax to these profits arises out of a complete misapprehension of the nature, function and purpose of these Corporations in developing new facets of our national economy, or exploring new resources.

Mention has already been made of the Industrial Finance Corporation established by specific Act in 1948. So far as the initial finance is concerned, it is privately owned; but it may be acquired by the State within a stated period and the compensation to be paid to the then shareholders is to be calculated on lines laid down in the Act. While it is privately owned, its capital and interest thereon is guaranteed by the State upto a minimum return; and also as regards the shares, bonds or debentures issued by it. A variation of this form is to be found in the creation of three Overseas Shipping Companies which are to be owned jointly by the State (51%) and each of the 3 existing shipping companies, which are to act as Managing Agents for the enterprise for 15 years. The total overseas shipping business is to be divided between them. A similar venture is made with the Airways Corporations, where the State has entered into partnership with a private enterprise holding 49% of the capital, and agreed to assist the new venture in every way so as to develop these services to their maximum potentiality. Wherever necessary, Agreements or Treaties will be made by the State to safeguard this business with Foreign enterprise wherever it exists in these fields, or with Foreign Governments if necessary.

The Hindustan Aircraft Factory is another case of a State Enterprise in a wholly new field. Originally started as a joint venture of the Government of India, the Government of Mysore and a private Corporation, it was meant to make planes and repair them in this country. With the advent of the Lease-Lend system, the American Government the only source for providing parts and accessories in an ever increasing volume, urged the elimination of the element of private profit from the working of this factory. Accordingly, the private partner and Managing Agent, was bought out, within one year

of the start of the enterprise, at the cost of a very considerable premium on the capital subscribed by him; and the venture is now run exclusively as a State concern. Yet another type of such Corporation is found in the Damodar Valley Corporation or the Electricity Board. These are, from the very start, entirely State-owned, and are to be conducted as so many Public Utility ventures, wherein the element of profit, or the desire to derive a commercial surplus of receipts over expenditure will not predominate. The results of these will be varied and spread over a number of directions, so that it would be impossible to assess their benefits on a strictly commercial basis. Great gains however, are expected from them when the projects, just begun, are completed.

The Reserve Bank of India has recently been nationalised, and is continued as one more wholly State-owned Corporation, governed by a specific Statute. This device of associating private enterprise with the State in the initial period when the public official set to manage such enterprise may be lacking in technical knowledge or experience has possibilities which, however, are not yet fully appreciated, and need to be properly integrated in an all-round National Plan. The corporations set up so far are **ad hoc** creations, not necessarily linked up with one another by any common, consistent bond. Their place also in the planned development of the country has yet to be determined. The older model of the Guaranteed Railways Companies of the XIX Century is considerably modified in these new forms. But their contribution to the development of the country and distribution of the wealth will only be possible to assess properly when such creations are scientifically interlinked and all of them integrated in the National Plan.

10. Development Plans.

Finally a few remarks may be added in regard to the Plans of the Provincial, State and Departments of the Central Government for Development. Reference has already been made to the Provincial Plans made since 1945, and proposals of the Central Government in regard to some of their own Departments, which have been outlined at some length in the 1946-47 Budget. We need not repeat that discussion here beyond observing that Scientific Planning on a national scale continues to attract attention from the leading Statesmen, and has the general sympathy from the public at large. But its definite formulation in a clear-cut Plan, in forms more specific and abiding than mere blue-prints, remains yet to be achieved.

K. T. Shah.

APPENDIX

War-time Budgets

The aggregate war expenditure in India including recoverable war expenditure during the period 1939-40 to 1945-46 came to Rs. 3,484 crores. India's share of this was Rs. 1,744 crores or about 50%, assuming that the recoverable Expenditure, now frozen as Sterling Balances is recovered. And this is without counting the additions India has had to make to her permanent Defence Budget, mainly because, of her dependance on an Imperialist Western Power. The over-all Governmental outlay during the War years—including civil expenditure, was Rs. 3,996 crores of which Rs. 1,462 crores or 37% was met from current revenue including increased taxation. The balance is partly found in the accumulated Sterling Balances, and partly in addition to India's public debt. That Debt has increased by Rs. 1,077 crores. The revenue increase does not show the increase in the Provincial Revenue.

The following table gives an idea of the change brought about by the War in India's public revenue, expenditure and debt between 1938-39 and 1945-46.*

(In crores of rupees)

	1938-39	1944-45	1945-46
I. Central Government Budget:			
Revenue	84.52	335.57	360.67
Expenditure	85 15	496.71	484.57
Deficit	—0.63	—161.14	—123.90
II. Total Governmental Outlay:	85.15	970.38	894.20
A. On India's Account:			
i) Civil Expenditure	38.97	101.22	124.34
ii) Defence Expenditure	46.18	458.32	395.32
B. Recoverable War Expenditure	—	410.84	374.54

*Cp. Indian Year Book, 1948, p. 718.

(In crores of rupees)

	1938-39	1944-45	1945-46
III. Central Government Debt at the end of the year:			
i) Sterling Loans:	464.94	34.19	33.84
ii) Rupee Loans	437.87	1,212.14	1,492.20
iii) Small Savings	141.45	159.18	221.52
iv) Treasury Bills and Ways and Means Advances	46.30	86.70	83.33
v) Total Interest Bearing Charges	1,205.76	1,860.44	2,282.38

Though Receipts increased in the aggregate, individual items of revenue showed strange vicissitudes. Customs began to shrink partly due to transport difficulties from Rs. 40,51 crores to Rs. 25,12 crores in 1942-43. Thereafter it recovered, being Rs. 39,76 crores by 1944-45 and very much more sharply in post-war years, being budgeted at Rs. 54.50 crores (revised estimates) 1947-48 and Rs. 81.22 crores for 1948-49. Central Excise Duties also expanded during war years partly on account of enhanced rate on existing items like tobacco, vegetable products, betelnuts, coffee and tea, and partly also by increased consumption. From Rs. 8.66 crores yield in 1938-39 it rose to

Rs. 38.14 crores in 1944-45 Revised

Rs. 46.65 crores in 1945-46

Rs. 34.00 crores in 1948-49 Budget.

Direct Taxation under corporation, income and excess profits taxes expanded much more heavily from Rs. 15.78 crores in 1938-39 (20% of the total revenue) to Rs. 136.18 crores in 1948-49 (Budget) representing about 54% of the total Central revenues. And that without counting the still more considerable evasion of these taxes which has admittedly taken place. Total tax revenue increased from Rs. 72.34 crores in 1938-39 to the peak figure of Rs. 282.67 crores in the revised estimates for 1945-46. The Budget of 1945-46 showed a decline to Rs. 239.15 crores while the latest Budget of 1948-49 puts the aggregate Tax Revenue at Rs. 269.70 crores. Non-tax revenue also spurted up, specially after 1940-41, owing mainly to increased contributions from Railways and Posts and Telegraphs, and the larger profits of the Reserve Bank of India. But the Commercial Departments particularly Railways, have shown a heavy shrinkage being actually a deficit in the Budget of 1948-49.

The expenditure under Defence mounted up steadily, especially after the entry of Japan into the war. From Rs. 49.54 crores in 1939-40 it rose to the peak figure of Rs. 458.32 crores in 1944-45, without counting the so-called capital cost. In the 1948-49 Budget Defence items aggregate Rs. 136.07 crores including Rs. 14.99 crores on capital account. This does not include the Interest and Service Charges on account of Debt incurred for warlike operations. The charges for the servicing of debt more than doubled from Rs. 14.12 crores in 1938-39 to Rs. 22.21 crores in 1944-45, and Rs. 61.82 crores in 1948-49 (Budget) less the Interest debited to commercial departments i.e. Rs. 25.65 or a net payment of Rs. 36.16 crores. This might have been larger still but for decreases in the effective rates of interest.

Deficits on revenue account grew steadily from Rs. 6.53 crores in 1940-41 to Rs. 189.78 crores in 1943-44. With the deficit of Rs. 161.14 crores during 1944-45 and Rs. 144.95 crores in the following year, the total volume of deficits during the period 1940-41 to 1945-46 came to Rs. 627.26 crores. The 1946-47 Budget added another Rs. 44 crores. The Revised estimates of 1947-48 put it at Rs. 6.58 crores, while the Budget estimate for 1948-49 gives it at Rs. 9 crores.

With the possibility of economy and retrenchment being effected on the termination of the War, the taxation proposals for 1946-47 offered a number of substantial concessions to industry and to persons of moderate means e.g. abolition of the Excess Profits Tax after the 31st March 1946; grant of special initial depreciation allowances of 10% on new buildings and 20% on new plant and machinery, as well as allowances for expenditure on scientific research for purposes of income tax; the scope of obsolescence allowance being liable to be widened so as to include the loss of an asset by destruction or demolition, and also extended to buildings; relief from Customs duty on raw materials imported for industry and reduction of rates on such imported plant and machinery as are now dutiable; a net reduction of 1¾ annas in the present total rate of Super Tax and Income Tax (payable by a company) by lowering the Super Tax by 2 annas and the raising of the Income Tax by ¼ anna; exemption from Income Tax for two years in the case of buildings for residential purposes, and an initial depreciation allowance of 15% for buildings used as business premises. reduction of the total rate on life insurance companies by 3 pies.

Other concessions included: reduction of the rate on the second slab of income of Rs. 3,500 from 15 pies, to 12 pies, and the rate on third slab of Rs. 5,000 from 2 annas 1 pie to 2 annas;

the raising of the earned income allowance from one-tenth of the earned income, (subject to a maximum of Rs. 2,000) to one-fifth (subject to a maximum of Rs. 4,000). In the Super Tax also there would be differential treatment in favour of earned income at the rate of 1 anna in the rupee between Rs. 25,000 and Rs. 2 lakhs and of ½ anna between Rs. 2 lakhs and Rs. 5 lakhs.

Under indirect taxation, the duty on kerosene oil was reduced by 1½ anna per gallon; reduction in the excise duty on betel nuts by one anna per lb; and 6 pies of the increase in the customs duty on betel nuts; reduction in the duty on unexposed cinematographs film from 6 pies per linear foot as originally proposed to 3 pies; reduction in the price of a match-box from 9 pies to 6 pies; of a postcard from 9 pies to 6 pies, to come into force respectively from August 1 and July 1, 1946.

Reductions in expenditure arising from the cuts by the Legislative Assembly amounted to Rs. 93.34 lakhs on revenue account and Rs. 3.46 crores under capital disbursements. In consequence of the changes in taxation and expenditure, the deficit of Rs. 44.06 crores for 1946-47 was expected to move up by Rs. 4.19 crores to Rs. 48.25 crores, with revenue at Rs. 341.87 crores and expenditure at Rs. 390.12 crores.

The Capital Budget was presented separately from the Revenue Budget.

The 1947-48 Budget.

The budget for 1947-48 estimated expenditure at Rs. 327.88 crores about Rs. 54 crores less than the revised estimate and Rs. 154 crores less than the accounts for 1945-46. The revenue, on the other hand, was budgeted at Rs. 279.42 crores on the basis of existing taxation, as against Rs. 336.19 crores in the revised estimates for 1946-47 and Rs. 360.67 crores in the actual for 1945-46.

In his budget the Finance Member was mindful that his proposals should be justified not merely on financial considerations but also by achieving certain social objectives like the reduction as far as possible of the glaring disparities of income between the classes and the masses. Proposals to afford relief to the lower income groups included abolition of the salt duty, at a net loss of Rs. 8.25 crores, and raising of the minimum exemption limit in respect of Tax on income from Rs. 2,000 to Rs. 2,500, involving a loss of Rs. 25 lakhs were intended to

realise these ends. Because of the consequential loss to revenue, the estimated deficit of Rs. 48.46 crores on the basis of existing taxation would be increased to Rs. 56.96 crores, without counting increase in expenditure resulting from the recommendations of the Central Pay Commission. This gap was proposed to be met by additional taxation:—

Estimated Yield in crores of rupees.

	Rs.
1. A Special Income Tax on 25% on business profits exceeding Rs. 1 lakh	30.00
2. A graduated Tax on Capital Gains exceeding Rs. 5,000 made in recent years from the disposal of capital assets	3.50
3. A change in the scale of Super Tax so as to reach the maximum of 10½ annas in the rupee at Rs. 1.2 lakhs for unearned income and at Rs. 1.5 lakhs for earned income	2.50
4. Doubling of the rate of Corporation Tax to annas 2	4.00
5. An increase in the Export Duty on Tea from annas 2 per lb. to annas 4	4.00
	44.00

The reports of the Select Committee on the bills relating to business profits tax suggested *inter alia* an abatement of five per cent of the capital at charge in the case of non-director controlled companies or Rs. 1 lakh, or whichever is greater; and a similar abatement of six per cent in the case of director—controlled companies. The exemption limit in the case of Hindu undivided families as well as partnership firms should be raised. On the capital gains tax, the Commitee recommended raising the exemption limit from Rs. 5,000 to Rs. 15,000 and fixing the tax at one anna in the rupee on the whole of Capital gains up to Rs. 50,000, raising by stages up to a rate of as. 5 in the rupee on the whole amount of capital gains exceeding Rs. 10 lakhs. The final acts reduced the rate of business profits tax from 25% originally proposed to 16-2/3 per cent; fixing a uniform abatement at six per cent, of the capital at charge or Rs. 1 lakh or whichever is greater, and exemption from the capital gains tax of gains from personal effects.

The Budget also proposed to raise by market borrowing Rs. 150 crores, as against Rs. 112 crores in the revised estimates, and Rs. 250 crores in the budget estimates for 1946-47. The small savings movement was also to be pursued more vigorously.

Referring to the financial aspect of post-war planning the Finance Member stated that the latest estimate showed that the total resources of the Centre, including borrowing, in the first quinquennium for purposes of reconstruction would fall substantially below Rs. 1,000 crores estimated by Government in 1944-45.

Public Debt.

With a further reduction in war-time expenditure and increased efforts towards minimising the deficit, there was a comparatively smaller addition to the Central rupee debt in 1946-47 than in the preceding year. The increase amounted to Rs. 203 crores against Rs. 366 crores in 1945-46. The market borrowings during the year was Rs. 112 crores, falling short of the long-term borrowing of Rs. 250 envisaged in the budget for 1946-47. This was due to preoccupation with conversion operations of the $3\frac{1}{2}\%$ non-terminable loans, the prevalence of Communal Disturbances and stringent conditions in the money market. Special oating loans were issued in the shape of non-negotiable, non-interest bearing securities for Rs. 139.25 crores for paying subscription to the International Monetary Fund, and for a part payment for buying India's quota of shares in the International Bank.

The public debt of India (including the unfunded debt and other obligations) registered a further increase of Rs. 198.17 crores at the end of March, 1947, with the total outstanding rising to Rs. 2,198.82 crores from Rs. 2,000.65 crores at the end of 1945-46. The Sterling Debt showed a slight decline from Rs. 63.70 crores at the end of 1945-46 to Rs. 59.06 crores made up of loans amounting to Rs. 55.44 crores and service funds of Rs. 3.62 crores.

The total interest-bearing obligations of the Government of India increased by Rs. 1,176 crores from Rs. 1,206 crores at the end of 1938-39 to Rs. 2,382 crores at the end of 1946-47 (revised). The figures include *inter alia* liabilities in respect of the British War Loan suspended since 1931-32, and the balances of Depreciation and Reserve funds of Railways, Posts & Telegraphs, and Income-Tax. Excluding these liabilities, the total regular interest-bearing debt would amount to Rs. 2,032 crores at the end of 1946-47 (revised) as compared with Rs. 1,158 crores at the end of 1938-39. The Budget placed the figure at Rs. 2,189 crores at the end of March 1948.

Assets.

Against this liability the assets of the Government of India were estimated at Rs. 1,515 crores comprising:

1. The Capital outlay on Railways, Rs. 808 crores;
2. The Capital advanced to other Central Commercial Departments of provinces and States, Rs. 122 crores;
3. The Burma Debt Rs. 48 crores;
4. The deposits with British Government to redeem Railway Annuities, Rs. 22 crores; and
5. The cash and securities held on treasury account, Rs. 514 crores.

Of the sterling Debt £324 millions was repatriated since 1937-38 at Rs. 430 crores. Stocks of the value of Rs. 156.76 crores were cancelled while rupee counterparts were issued in respect of the balance of Rs. 273.58 crores.

August 15, 1947.

After the Partition on August 15, 1947, a Supplementary Budget for the period August 15, 1947 to March 31, 1948 was presented for the Union of India. Existing taxes and duties were to be continued and a common currency system, managed by the Reserve Bank would remain upto the end of September, 1948. The initial liability for the outstanding loans, guarantees, Pensions and other obligations of the undivided Government at the time of the partition would be assumed by the Indian Dominion subject to an equitable contribution from Pakistan. The net deficit on revenue account was Rs. 26.24 crores with revenue of Rs. 171.15 crores and expenditure of Rs. 197.39 crores from August 15, 1947 to March 31, 1948. The expenditure estimates include Rs. 22 crores for the evacuation and relief of refugees and inflated defence expenditure. The existing export duty of three per cent on cotton cloth and yarn will be replaced by a duty of as. 4 pr square yard on cotton cloth and as. 6 a lb. on cotton yarn.

Budget for 1948-49

The main features of the 1948-49 budget for the Union of India are summarised below:—

(In crores of rupees)

	15-8-47 to 31-3-48 Budget	15-8-47 to 31-3-48 Revised	1948-49 Budget
Revenue ..	172.80	178.77	230.52
Expenditure	197.39	185.29	257.37
Defence	92.74	86.63	121.08
Civil	104.65	98.66	136.29
Revenue Deficit	24.59	6.52	26.85

The proposals for now taxation, adjustments or reliefs included:

(1) Reduction in business profits tax from 16 2/3 per cent. to 10 per cent. and the increase in the abatement from Rs. 1 lakh or six per cent. on the capital employed to Rs. 2 lakhs or six per cent, whichever is larger.

(2) Increase in the application of the maximum rate of super-tax from 1½ lakhs for earned and Rs. 1.2 lakhs for unearned income, to Rs. 3½ lakhs for both earned and unearned income, together with a re-arrangement of the slab.

(3) Abolition of the penal super-tax on companies distributing dividends above certain percentages, and a rebate of one anna in income-tax on undistributed profits, i.e., as 5 on distributed profits and as. 4 on undistributed profits of companies.

(4) Reduction of income-tax on companies with an income of Rs. 25,000 and below to half the usual rates.

(5) Exemption of donations to approved institutions and charities from taxation, subject to a maximum of five per cent. of the companies' taxable income, and 10% of individuals', with an overall ceiling of Rs. 2½ lakhs.

(6) Deduction of municipal taxes on property from the assessable income.

(7) Conversion of the export duty of as. 4 per sq. yd. on cotton cloth into 25 per cent. *ad valorem*, and exemption of handloom cloth from export duty, and withdrawal of the export duty on cotton yarn.

(8) The withdrawal of the Excise Duty on betelnuts.

The net effect of the changes will be a drop of Rs. 6.46 crores in the revenue.

New Taxes.

The new taxation proposals were:—

(1) Levy of an export duty of Rs. 80 per ton on oilseeds, Rs. 200 per ton on vegetable oils, and of Rs. 20 per ton on manganese.

(2) Increase in import duty on motor cars from 45 per cent. to 50 per cent. with preference of 7½ per cent, for the United Kingdom.

(3) Excise duty of 25% on the ex-factory prices of cigarettes and increase in the excise duty on certain categories of un-manufactured tobacco from as. 9 to as. 12 per lb. in some cases and from as. 3 to as. 4 per lb. in others.

(4) Increase in excise duty on tea from as. 2 to as. 4 per lb; on coffee to as. 4 per lb; on vegetable products by 50% to Rs. 7-8 per cwt.; on tyres by 50 per cent. and on matches by Rs. 2-8 per gross on all boxes containing upto 50 matches.

(5) Increase in postal registration fee from as. 3 to as. 4, and increase in surcharges on trunk calls from 40 per cent. to 60 per cent. and their amalgamation with the basic rate.

(6) Increase in the corporation tax from as. 2 to as. 3, with a rebate of one anna to companies declaring and distributing dividends in India. In the aggregate, these proposals are designed to yield Rs. 17.72 crores.

This readjustment of taxes was estimated to yield Rs. 11.26 crores, of these Rs. 10 crores were proposed to be transferred to revenue by crediting advance payments against taxes, instead of treating them as deposits. There would still be a deficit of Rs. 5.59 crores; but since the railways were expected to contribute Rs. 4½ crores to the general revenue, the net uncovered deficit was expected to be Rs. 1.09 crores.

The Budget included a provision of Rs. 10 crores for Refugee Relief and Rehabilitation, besides Rs. 10 crores for setting up a Rehabilitation Finance Corporation for the same purpose. Expenditure on this account in 1947-48 will amount to Rs. 14.89 crores against Rs 22 crores included in the Interim Budget.

Food subsidies in 1948-49 were estimated to cost Rs. 19.91 crores, the total Food Imports in the first half of 1948 being expected to cost Rs. 61 crores.

The Capital Budget for normal requirements and to finance the Central and Provincial schemes was estimated at Rs. 165.5 crores in 1948-49. For this market borrowing would be about Rs. 150 crores, and more if conditions are favourable.

Settlement with Pakistan

On a rough estimate, the outstanding debt of the undivided Government of India on August 14, 1947, was about Rs. 33,00 crores, against which assets available were valued at Rs. 28,00 crores thus leaving a net excess of liabilities of about Rs. 500 crores. The arrangement with Pakistan lays down that for

all assets located in her territory, she would take a debt equal to their book value, except strategic railways, valued at Rs. 32 crores, written down to 145 crores. Pakistan would also take over a debt equal to the amount of the cash balance of Rs. 75 crores, being her share of the cash balance of the undivided Government, and 17½ per cent. of the net excess of the Central Government's liabilities over its assets.

Pakistan's debt will, however, be reduced by the liability she takes over in regard to Postal Savings Bank, Postal Cash and National Savings Certificates, outstanding in her area, pensions of the undivided Government paid in Pakistan, and the liability for pensions earned by officers who have opted for service there. Pakistan's share will be in the form of a interstate debt to India. On a very rough estimate this debt will amount to Rs. 3,00 crores at 3% interest.

The total debt of Pakistan will be repaid in Indian rupees in 50 annual equated instalments for principal and interest, the repayment commencing in 1952.

New Financial Year.

At the existing level of taxation the total Revenue for the year would be Rs. 230.52 crores and the expenditure charged to revenue Rs. 257.37 crores, with a deficit of Rs. 26.86 crores.

Post-War Planning.

The 1948-49 Budget made substantial provision for Post-War Planning and Development. No reduction was made in the assistance promised, by the Centre to the provinces, when the latter were asked to draw up their plans for development. After allowing for the expenditure incurred up to Partition and for the areas now in Pakistan, the outstanding balance of assistance to the provinces at the end of 1947-48 was estimated at Rs. 170 to 180 crores. For Central schemes of development, including resettlement, a provision of Rs. 10.77 crores was made in the revenue budget, and Rs. 25.5 crores in the capital budget for 1948-49.

In addition Rs. 26.5 crores was provided in 1947-48 and Rs. 76 crores in 1948-49 for ordinary capital expenditure. The total provision in the Capital Budget for normal requirements as well as to finance development schemes, both for the Centre and the Provinces, totalled the impressive figure of Rs. 76 crores in 1947-48 and Rs. 165.5 crores for 1948-49.

In the large receipts of E.P.T. and B.P.T. continued in 1948-49 the revenue in 1949-50 may be Rs. 20 crores less than in the previous year. Refugee expenditure may, however, be reduced as also foodgrains subsidies and defence. A balanced budget may therefore be expected in the near future.

Debt Position.

The total interest bearing obligations at the end of 1948-49 were estimated at Rs. 2,231 crores against interest yielding assets valued at Rs. 1,237 crores, while cash and other investments amounted to Rs. 1300 crores leaving a final uncovered debt of Rs. 864 crores. The proportion of the country's debt to its national income also compares favourably with more advanced countries like the U.S.A. and the U.K. This country's debt is only half its probable national income, while in the U.S.A. it is more than $1\frac{1}{2}$ times, and in the U.K. nearly 3 times the national income. The net burden of interest on the deadweight debt in India amounts to only $10\frac{1}{2}$ per cent. of the revenue next year.

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